VENTURE CAPITAL AS FINANCIAL SOURCE FOR SMEs IN TRANSITIVE ECONOMY OF SLOVAKIA AND HUNGARY

Ph.D. dissertation submitted

by MARIÁN GÁL, lecturer, University of Technology in Košice (SK)

to the "Enterprise Theory and Practice"

Doctoral School

at the Faculty of Economics

University of Miskolc (Hungary)

Supervisor:

Prof. Dr. Nagy Aladár DSc.

University lector

2007

CONTENT

1 INTRODUCTION

The so-called transition economies are commonly understood to refer to countries, which have moved or are moving from a primarily state-planned to a market economic system with private ownership of assets and market-supporting institutions. These countries include those of the former Soviet Union and those of Eastern and Central Europe closely allied with the Soviet Union as well as those from Asia or Africa undergoing market transformation.

While the transition in these countries differs in many respects, including culture, economic structure and extent of the informal sector and pre-transition starting points, they nonetheless are affected by transition in much the same way. The transition process has brought about significant short-run costs to the economies that are by now well-documented. The dismantling of the state-owned enterprise systems has resulted in increases in poverty as wages dropped in the face of disruptions in trade and financial links, unemployment increased in some cases as newly private firms struggle to become competitive and vulnerable groups generally were not able to rely on heavily state-subsidized support services. These changes were exacerbated by the collapse of traditional trading relationships and fiscal shocks to state budget.

The combined effects of these shocks have been dramatic. Many countries tried to hold together elements of the old social protection systems, including safety nets. The key issue for safety nets provision in transition economies has been how to maintain it as an adequate mix of appropriate assistance for the poor and vulnerable while adhering to tighter budget constraints and changing government and institutional structures. The adjustments are ongoing.

Political economy arguments, along with being used in the context of the pace and sequencing of reforms, have also been used extensively to explain or justify many aspects of the transition process. For example, mass privatisation, involving the giveaway of state assets to citizens or to workers was designed to overcome political constraints to transition. The different privatisation methods were also country-specific. Thus, for example, the Czech Republic opted for mass privatisation, Hungary went primarily for sales to foreign investors, while MEBOs were wide-spread in Poland. This made studies on the effectiveness of privatisation methods difficult (if not impossible) since one could not control for the impact of the overall economic environment. Slovakia provides the best natural experiment among all transition economies since it is the only country which has adopted all three privatisation methods over a large number of former state-owned firms.

Restructuring of large state-owned firms, on the other hand, was also one of the key impulses to strengthen the economic growth. Different approaches to restructuring have been extensively debated. However, it is often not clear what “restructuring“ means. Does restructuring refer to a single firm or the entire economy? How is restructuring different from the normal process of growth and change? How does one measure restructuring? At the plant level? Economy wide? Restructuring is probably best understood as the transition process from a highly distorted economy with many loss-making firms to a “normal” market economy in which the overwhelming majority of firms are profitable [45].

Various aspects of enterprise reform can be identified: managerial autonomy, competition, privatisation, concentrated ownership, hard bank lending, and financial discipline, including bankruptcy and liquidation. The relative importance each of these factors in enhancing enterprise restructuring is unknown. This is likely because restructuring is influenced by not just one, but a large number of factors, each of which contributes an essential, but often statistically marginal aspect to enterprise reform.

Empirical studies on firm behaviour in transition economies agree on three broad determinants of the speed and depth of restructuring: a firm's initial conditions ("inheritance"), enterprise-specific factors (corporate governance, managerial ability), and the external environment (macroeconomic stability, import competition, financial discipline, the bargaining power of labour unions). Initial conditions for providing the economy transformation should include several important conditions. [12, 18,19][1]

Political economy arguments have also been used to explain the striking difference in economic performance across transition countries. While all transition economies experienced a fall in output at the beginning of the process, most countries in Central and Eastern Europe recovered growth after a few years. Another political economy argument suggests that central European countries were expected to access the European Union, which enhanced incentives to create patterns of law enforcement, law compliance and protection of property rights.

[1] According to the studies elaborated by Estrin and Takla (in 1994-1995), and Classens (1996) these initial conditions for the economy transformation include: sector of activity, the pre-transition level of productivity, firm size and the inherited debt burden. Firm-specific factors include the structure of property rights, especially the extent of progress towards full privatisation, the presence and type of outside owners, the ability (and willingness) of managers to attract foreign partners, and more generally to ensure access to better technology, intermediate inputs and capital goods.

A **transition economy** can be understood as an "economy which is changing from a planned economy to a free market" [86]. Transition economies undergo economic liberalisation, enabling market forces to set prices and lowering trade barriers, macroeconomic stabilisation, where immediate high inflation is brought under control, and restructuring and privatisation, in order to create a financial sector and move from public to private ownership of resources. These changes often lead to increased inequality of incomes and wealth, dramatic inflation and a fall of GDP.[2]

Transformation of the post-socialist economies would not be possible without private capital. There are several different sources that can contribute to the growth of the economy. This dissertation aims to describe the role and nature of private capital of small and medium size enterprises and focuses on up-to-date form of capital – the venture capital.

Fundraising with venture capitalists can remain a largely mysterious process. In a world shrouded with non-disclosure agreements, the entrepreneurs are often unaware of the common practices of deal terms and are unable to benchmark their term sheets with respect to those given to others. Inherent conflicts of interest in the split of the financial returns, liquidation, and control of the company lead the venture capitalists to structure the deals which benefit their interests at cost to the interests of the entrepreneurs.

Venture capital financing is attractive due to many reasons. Venture capitalists (VCs) allow the entrepreneur to raise all the money from one place. Given that VCs are in the business of building businesses, they have plenty of experience with the challenges of start-ups. Also, VCs usually have been through the process growing the company to Initial Public Offering (IPO) and other desired liquidation events [43]. VCs usually have a large rolodex of contacts which can help the company become successful. VCs can also give assistance in hiring members of the management team if necessary.

Furthermore, "venture-backed firms also perform significantly better after they go public than similar non-venture-backed firms" [10].

Although the reasons to seek venture capital are obvious, the entrepreneur and the venture capitalist must be aware of the conflicts of interest that exist between them. Deal terms structured by the venture capitalist should address these conflicts of interest by minimizing the risk and maximizing the returns for the VC. Structuring deal terms in the venture capital world can be a very complex process. Venture capitalists have the daunting task of taking huge risks by investing a very significant amount of money into sometimes

---

[2] See further definitions and characteristics of transition and transition process in the Middle and East European countries in the following chapters.

nothing more than a business plan. They also have the luxury of rejecting 99% of all investment opportunities that come their way. Conflicts of interest occur between the VC and the entrepreneur because there is a difference between some of their goals and objectives. In an effort to minimize their risk and maximize their Return on Investment (ROI), the VC often asks for provisions that align their interests with the interests of the entrepreneur [54].

Conflict of interest (1) occurs due to the following: The VC wants to give the entrepreneur just enough percentage of the company to keep them motivated until the liquidation event, and the entrepreneur wants to give the VC just enough percentage of the company so that the VC will choose to invest. In this way, the VC and the entrepreneur have a conflict of interest in regards to their view of the appropriate way to split the financial return of the company.

Conflict of interest (2) occurs due to the following: VCs have very precise timetable expectations of when and how they want their shares liquidated. The VCs set these timetables for the companies which they have funded. These timetables must match the timetables which were dictated by investors of the venture capital fund. The VCs and their investors agree on a length of time (generally 5 years) that the VCs have to fund companies with the investor's money. The VCs must hold the funded companies to a precise timetable because they must return the money to their investors at that previously agreed time. To receive funds according to their timetable, VCs can set provisions which extract value to meet their objectives. In contrast to VCs, entrepreneurs are generally involved in management of the company for a longer period. The VCs also want preference to any shareholders. In other words, VCs want their money in any liquidation event before any of the other common stockholders receive anything. The difference (between VCs and entrepreneurs) in timetables and the preferences for shareholders when there is a liquidation event of the company is a conflict of interest in regards to liquidation of the company.

Conflict of interest (3) occurs due to the following: After investing, the VC is now part owner of the company and needs to be consulted on how money is being spent. Furthermore, the VC wants rights which will ensure that management is performing well and maximizing returns. Conflict over control of the company thus naturally arises between the entrepreneur and the VC as a struggle for power over company decisions ensues. From these conflicts of interest, an inherent power struggle is created where the VC wants to minimize risk and maximize returns but the entrepreneur wants to share risk and receive the VC investments.[3]

---

[3] These conflicts were studied also within the work of Shirkir, S.: Structuring venture capital Deals. 2006.

Venture capital is not suitable for all entrepreneurs. As described below in dissertation, firms suffering from lack of attainable capital from foreign sources try to find new ways and possible financial means in order to continue in their entrepreneurial activities. Moreover, banks usually are not willing to provide loans to start-up companies (see also chapter 3.3) and thus such loans may become too expensive for small entrepreneurs if they use them to improve their financial position. On the other hand, since SMEs are indebted they seek for different forms of capital that would allow further survival and latter also development and improvement of their position on the market. At presence, one of such new forms of capital is a venture or equity capital. Venture capitalists are very selective in deciding what to invest in; as a rule of thumb, a fund invests only in about one in four hundred opportunities presented to it. They are most interested in ventures with high growth potential, as only such opportunities are likely capable of providing the financial returns and successful exit event within the required timeframe that venture capitalists expect. Because of such expectations, most venture funding goes into companies in the fast-growing technology and life sciences or biotechnology fields. Because of these strict requirements, many entrepreneurs seek initial funding from angel investors [27].

If a company does have the qualities venture capitalists seek such as a solid business plan, a good management team, investment and passion from the founders, a good potential to exit the investment before the end of their funding cycle, and target minimum returns in excess of 40% per year, it becomes much easier to get venture capital.

2 PRESENT STATE OF ART

2.1 Reasons for choosing the theme

The emphasis on small and medium enterprises (SME) development in the Eastern and Central Europe parallels the shift in emphasis in the EU countries from developing economies of scale to fostering small, innovative companies. The reorientation reflects both shifts in the industrial structure of Western economies over past two decades and a growing emphasis in EU policy to foster SMEs in the underdeveloped and more peripheral regions of the Community, and in the regions worst affected by structural adjustment and less likely to attract foreign direct investments. As in EU programmes, the goal of fostering job creation and growth in disadvantaged regions is conducted through policies aimed at overcoming institutional constraints such as obtaining finance and developing an adequate infrastructure. In transition countries the need to develop business skills in areas such as marketing and bookkeeping is given special emphasis.

Transformation of Hungarian and Slovak economies and their transition from planned to market economies were the major and key elements in the development of private ownership and small and medium-sized businesses. Hungarian transition model succeeded in the economic transformation as the first within the Middle European countries (Lavigne, 1999; Kornai, 1990). This model included decentralisation in decision-making processes, price liberalisation and flexibility, enterprise autonomy, and bankruptcy law (Kornai, 1994, 2000, 2005). The main building block of the economic transformation and transition from planned to market economy was privatisation of the state property, emerging of private forms of ownership, market-orientation of firms, commercialisation, new banking and taxation systems, new legal forms of trading and what is the most important, such economic transformation has brought the brand new forms of capital and financial opportunities for not only start-up companies, but also for those developed suffering from lack of financial means – a venture and equity capital (Lavigne, 1999; Kornai, 1992, 2005, Admati, Pfeiderer, 1994). The number of market actors multiplied and private property became dominant in Hungary and Slovakia. SMEs have become the most numerous category taking over the bulk of the activities of the former large state-run enterprises (Berger, Udell, 1998; Carlin, 1995;Estrin, Takla, 1995).

In former Czechoslovakia the situation in the economic transformation was slightly different comparing to Hungary, the country was rather conservative. The economists were deciding what kind of privatisation of state property to choose: coupon privatisation and thus to allow citizens to participate directly on state enterprise shares' ownership or just direct sale to big investors. It was considered to implement both types of privatisation and to reject division of big state enterprises into smaller units (Kolodko, 1992; Šulc, 1993; Urban, 1994). The inflow of new forms of borrowed capital – venture or equity capital was rather slow, accelerating in the second half of 1990's (Wright, Robbie, 1998; Záborský, 2001).

Comparing to USA or to former EU-15 member states, the venture capital in Hungary and Slovakia was undeveloped and entrepreneurs are still unaware to face its advantages and possibilities in its further usage and finance of their needs (Ueda, Hirukawa, 2003; Shikhir, 2006; Romain, 2004).

Transformation recession was combined with mentioned significant changes in the market orientation, legislation and economic changes which brought new chances to raise the living standard of citizens. These changes also brought new chances for both emerged entrepreneurs as tradesmen and several forms of corporations such as limited companies, incorporated companies, co-operatives and many others, and finally they allowed development of various forms of capital.

One of the reasons to choose the theme of dissertation was to analyse the impact of the most up-to-date form of capital – venture capital in SMEs on their profitability, market share, basic financial indicators, etc. as described later on in further chapters.

Since the beginning of 1990's, the role of investments has gained ground in the retail sector through the building of shopping centers, supermarkets, and discount networks. Today's building boom in both countries reorganized retail structures to the detriment of small businesses with domestic ownership.

In summary, the foreign investments contributed to:

- the establishment of new industrial branches in both countries,
- the quick development of the backward services sector,
- the spreading of modern technological and technical methods,
- the development of professional marketing.

In comparison to privatization investments, investments created new capacities, new jobs and new services which constitutes one of the sources of the Slovak and Hungarian economic growth. They played an important role in the process of accumulation of fixed capital (Blanchard, 1997).

The wave of liberalization at the end of the 1980's created large-scale possibilities for private individual undertakings and partnerships. A lot of private undertakings appeared in the retail, services, building industry, and agriculture. This mainly concerns undertakings with little capital and few employees.

The area of my research are the small and medium sized enterprises (SMEs) and their interactions and relationships on the market, their cooperation with public sector organizations and strengthening the public-private partnership. The activities focus on problems that small and medium size firms in Hungary and in the Slovak Republic face in the transition process from planned economy to the market economy. The main attention is paid to financial sources of SMEs, how the SMEs are capable to obtain necessary capital to provide their activities and compete on the market. We focus on venture and equity capital that serves in certain cases as replacement capital for expensive borrowed financial sources. As far as venture capital is a new term in the conditions of Hungarian and Slovak economy and entrepreneurs are still hesitating whether to allow a foreign partner to become part of the management, to share profit, to make decisions about the product and market specialization, etc. we present its main characteristics, advantages, investment process since the first contact till exit of investment fund from company, impact of venture capital on concrete firms that used them in the past and inform about the venture and equity capital providers and thus we want to clarify venture capital nature and support its usage in practical business. Such a theme is therefore important to be studied and investigated in this territory in order to help firms regain their competitive strength in a tough fight with domestic and foreign competitors. What is more, this reflects the field of my study and future career specialisation. These are the main reasons for choosing the theme.

2.2 Objectives, hypotheses and methodology of dissertation

2.2.1 Scientific objectives

The main scientific objective of the PhD dissertation is on a basis of SME analysis in transitive economies of Hungary and Slovakia to determine usage and impact of venture capital on profitability, growth, market share and position of analysed SMEs and thus explore their trading activities in every day business and explain the role of SMEs in the transition from planned economy to the market economy. An attention will be paid to the role and specific functions and positions of the SMEs:

- their specific issues,
- characteristics in the transition economies,

- differences, similarities and functions of the SMEs in both countries,
- sources of SME financing in Slovakia and in Hungary with emphasis on venture capital,
- how venture capital contributes to their effective performance, to lowering the costs, how it contributes to higher sales and profits, and market shares,
- their contribution on macroeconomic level to GDP growth, to employment, to export of goods and services, and to national balance of the country.

In order to achieve scientific objective of dissertation I set up the following partial objectives:

- to analyse transition of Hungarian and Slovak economy from planned to market economy,
- to analyse SME performance during the transition period,
- to determine the main elements and indicators that created market environment for the SMEs,
- to compare the impact of SMEs on Hungarian and Slovakian economy,
- to draw a comprehensive analysis of financial sources of SMEs,
- to characterise venture capital as modern and important financial source for SMEs,
- to indicate problems that perceive the entrepreneurs before they decide to use venture capital,
- to explain the role and impact of venture capital on financial performance and economic results of chosen SMEs,
- to formulate the recommendations for the entrepreneurs on a basis of provided analysis in chosen firms.

2.2.2 Hypotheses

On the basis of the analysis of theoretical facts I set up the following hypotheses:

H 1: I suppose that privatisation of state property and changes in legislation were the major challenges in creation and establishment of SMEs in both countries.

H 2: I suppose that SMEs contribute to growth of the macroeconomic indicators: they increase GDP, create value added, increase employment and contribute to stabilization of price level.

H 3: I suppose that the most significant and important source of SME financing in Slovakia and Hungary are own sources – mainly profit, and bank loans and leasing from borrowed sources.
H 4: Growth of venture capital as a financial source of SMEs contributes to their growth and thus accelerates the growth of macroeconomic indicators. On micro level, venture capital growth stimulates the effectiveness of SMEs, labour productivity and thus contributes to higher sales and profits.
H 5: I suppose that venture capital in analysed enterprises contributed significantly to increased revenues, better economic performance and indicators.

2.2.3 Methodology

In order to achieve the scientific objective and all partial objectives of dissertation the methods will be appointed and specific methodology applied. The theoretical facts and figures will be collected from secondary research – from the relevant literature both from foreign and domestic sources. The survey of the literature will concentrate on (1) how Hungarian and Slovak economies ran through the transition period, how these countries changed their market environment, legislation and what was the impact of transformation changes on SMEs; (2) the economic policy of the SMEs, their specific characteristics and financial sources; (3) implementation of new forms of investments – a venture capital into SME capital sources and its usage in successful competition fight.

The Hypothesis 1 and 2 will be verified and tested by collecting the theoretical issues from sources mentioned above and thus the theoretical basis will be created in order to provide a constant switch from theory to practice and to allow an easy use of theoretical knowledge in practice. In Hypothesis 1 I will examine what were the main reasons and what methods in each country were chosen to support and allow creation of SMEs. Final interpretation and confirmation of tested hypothesis will be provided after the analysis of transition process and system of SME creation in both countries. Hypothesis 2 will be verified by determining and testing depending variables (number of SMEs, growth of SMEs, share of SMEs on total employment) and independent variables (GDP growth, employment growth, inflation rate), which will be associated in cross tables in order to confirm statement that SMEs increase GDP, employment rate, contribute to stabilisation of inflation rate, and create value added. Final judgements of set hypothesis will be provided after whole analysis of SME sector both at macro and micro levels in analysed countries is provided.

Required data will be collected from:

- Taxation legislation of Hungary and Slovakia,
- Commercial code of both analysed countries,
- EU directives and recommendations,
- Information from the capital markets,
- Data from statistical offices and national banks of both countries,
- Scientific literature, magazines, newspapers, conferences.

Hypothesis 3 will be verified by analysing data from researches, statistic evaluations and opinions of entrepreneurs' surveys done by the institutions listed in literature. All possible financial sources of SMEs will be verified and calculated, compared with each other and thus final justifications and statements provided.

The final chapter is dealing with the analysis of concrete existing SMEs that applied the venture capital and thus serve as a positive example for the other entrepreneurs who are suffering from lack of capital and are unable to obtain less expensive sources concerning the interest payments of both banking and non-banking institutions after accepting a loan or certain provisions such as leasing price when purchasing some goods and equipments from company by leasing. Data from SMEs such as revenues and costs were collected from financial statements and elaborated using the financial analysis' qualitative and quantitative methods. Except of total revenues and sales, profitability/return on assets (ROA) and profitability/return on equity (ROE) were calculated by following formulas:

$$ROA\ (\%) = \frac{net\ income}{own\ capital} \times 100\ ,$$

$$ROE\ (\%) = \frac{net\ income}{total\ equity} \times 100\ .$$

The SMEs were chosen in order to introduce the possibilities of venture investments and to demonstrate the positive influences and impacts of venture capital on SMEs and thus support its usage in practice.

Stated hypotheses 4 and 5 will be verified and tested on a basis of secondary research from relevant sources as described upper in this subchapter with combination of the results of primary research of data about the economic performance of selected SMEs using the financial analysis methods. Testing variable will be growth of venture capital as a financial source for SMEs, impact of venture capital on financial performance of SMEs in general, and in the final chapter on concrete chosen SMEs, their financial stability and profitability. Final statements will be provided after the venture capital is introduced, characterised and defined, and after all calculations mentioned above provided.

Since a lot of research works of the Slovak and Hungarian SMEs by world agencies have already been provided (NADSME, EVCA, MESA10, Statistical Office and the others listed in literature), the knowledge and facts collected and summarised, the main contribution of submitted dissertation is to describe the new form of capital – venture capital as possible financial source for emerged start-up companies and for SMEs with lack of financial sources from own capital or from expensive borrowed sources, its impact on concrete chosen SMEs that used venture capital in order to develop their trading activities and thus obtain further competitive advantages and also to summarise reached data and thus compare Hungarian economy with the Slovak economy during their transition from planned to market economy and, finally, the impact of transformational changes on analysed SMEs.

The methodological solution of dissertation (as showed in Scheme 1) consists from following steps:

1. Statement of scientific objective and partial objectives of dissertation.
2. Formulation of research hypotheses.
3. Choice of research SME sample.
4. Determination of methods to collect data from secondary research and from selected SMEs.
5. Determination of methods to evaluate the influence of venture capital on SME financial performance.
6. Realisation of secondary research.
7. Collection, division and statistical elaboration of data from secondary research and from selected enterprises.
8. Analysis of knowledge, facts and data.
9. Verification of hypotheses, their confirmation or rejection.
10. Comparison of outputs.
11. Discussion.
12. Formulation of partial theses.
13. Formulation of final conclusion – on a basis of partial theses we will provide final recommendations to those SMEs that are still hesitating whether to use and implement venture and equity capital in their enterprise.

There are certainly more factors contributing to a favourable private equity and venture capital environment than have been selected for the analysis in dissertation. An effort was made to select those aspects that are most relevant for a well-functioning private equity and venture capital. Not only I calculated profitability of SMEs, but also indicator EBIDTA – earnings before interest, taxes, depreciations and amortisation. This indicator was calculated on a basis of company's income statement. Although such indicator was rather of partial interest only comparing to ROE and ROA, since the distortion accounting and financial effects on enterprise earnings do not factor into EBIDTA, but I could have used it for a comparison of position and performance of selected enterprises using venture investments with some of the same branch.

I decided to use these indicators and model that would determine success or failure of selected SMEs in their decision to use venture capital in a form of either rescue or developing capital. Such indicators are generally used and accepted in determining the financial performance of SMEs in the market economies.

Figure 1: Methodological solution of dissertation.

Introduction

1. Scientific objective of dissertation

On a basis of SME analysis in transitive economies of Hungary and Slovakia determine usage and impact of venture capi on profitability, growth, market share a position of analysed SMEs and thus expl their trading activities in every day business and explain the role of SMEs in the transiti from planned economy to the market econom

1.1. To analyse transition of Hungarian and Slovak economy from planned to market economy.

1.2. To analyse SME performance during the transition period.

1.3. To determine the main elements and indicators that created market environment for the SMEs.

1.4. To compare the impact of SMEs on Hungarian and Slovakian economy.

1.5. To draw a comprehensive analysis of financial sources of SMEs.

1.6. To characterise venture capital as modern and important financial source for SMEs.

1.7. To indicate problems that perceive the entrepreneurs before they decide to use venture capital.

1.8. To explain the role and impact of venture capital on performance and economic results of chosen SMEs.

2.1. I suppose that privatisation of state property and changes in legislation were the major challenges in creation and establishment of SMEs in both countries.

e
e
d
analysis in chosen firms.

2. Hypotheses

2.2. I suppose that SMEs contribute to growth of the macroeconomic indicators: they increase GDP, create value added, increase employment and contribute to stabilization of price level.

2.3. I suppose that the most significant and important source of SME financing in Slovakia and Hungary are own sources – mainly profit, and bank loans and leasing from borrowed sources.

2.4. Growth of venture capital as a financial source of SMEs contributes to their growth and thus accelerates the growth of macroeconomic indicators. On micro level, venture capital growth stimulates the effectiveness of SMEs, labour productivity and thus contributes to higher sales and profits.

2.5. I suppose that venture capital in analysed enterprises contributed significantly to increased revenues, better economic performance and indicators.

3. Choice of research SME sample.

Selection of 2 Hungarian and 2 Slovak SMEs.

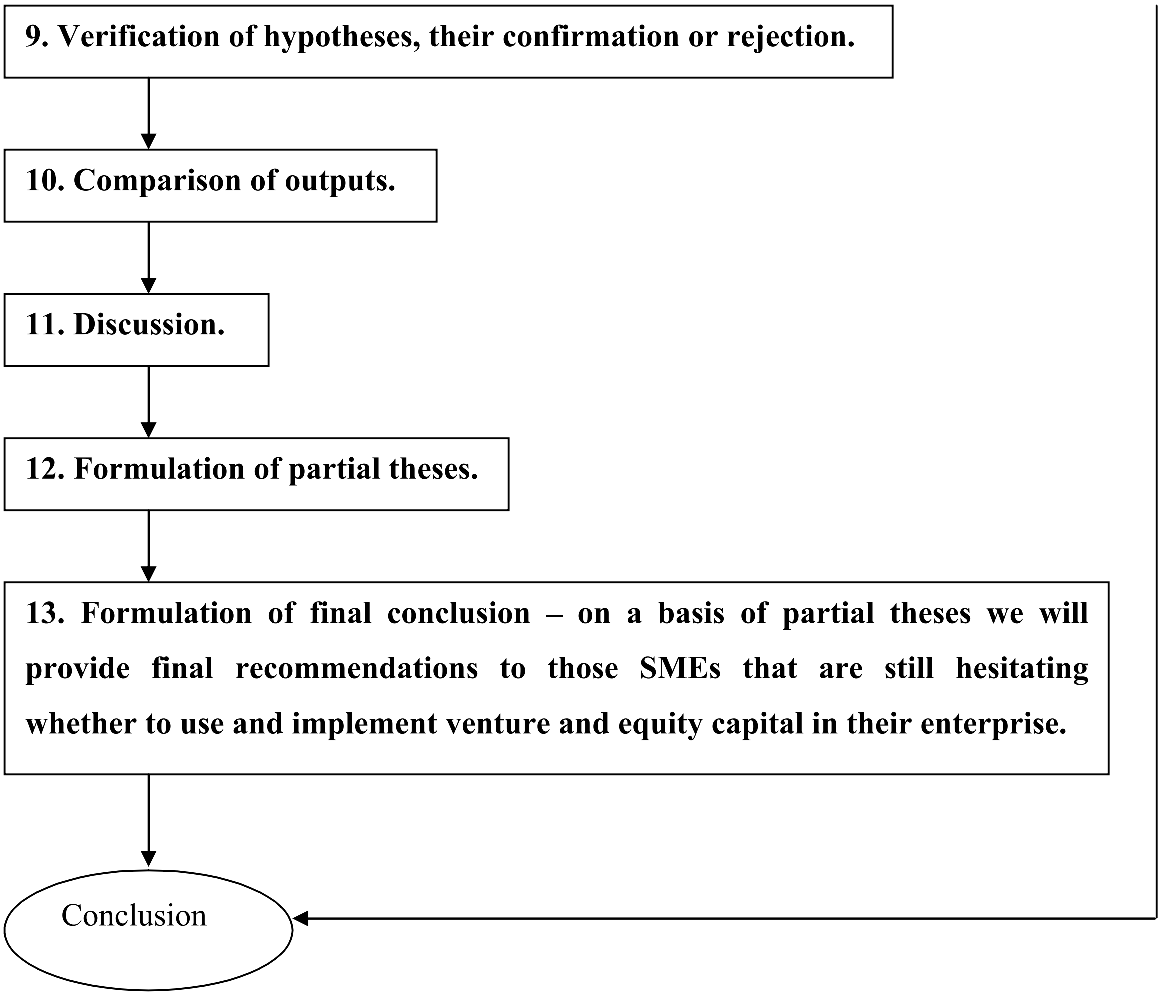
4. Determination of methods to collect data from secondary research and from selected SMEs.

5. Determination of methods to evaluate the influence of venture capital on SME financial performance.

6. Realisation of secondary research.

7. Collection, division and statistical elaboration of data from secondary research and from selected enterprises.

8. Analysis of knowledge, facts and data.



Source: Own elaboration.

2.3 Perception of transition

Until recently, the world was divided into the first, second and third world. The notion of the second world has now lost its substance. Since the Berlin Wall was breached on 9 November 1989, the former socialist countries have remained on top of the agenda in the Western media, not only because of dramatic political developments such as the anti-Gorbachev coup and the collapse of the USSR in 1991, or because of the lingering state of war in the former Yugoslavia and in parts of the former USSR. Economic developments make headlines as well. The transition to the market arouses public interest out of proportion to the share of these countries in the world economy. Western governments are eager to keep informed, to understand, to help, to advise, to trade, to invest, to be involved in one way or another. Problem of transformation of centrally planned economies to market economy found the economic science unprepared for answering of basic questions that were about to be solved by economic practice after collapse in 1989. [58]

Transition to the market is now acknowledged as a long-lasting process which might extend to a whole generation, structural transformation seems very slow. East and West are now parts of the same world. Now there is just an economic division between rich and poor countries. There is no longer a systemic division.

We may argue whether Western model has succeeded in the East or whether Middle and East-European countries are able to reach the level of development of former EU-15 countries. Nowadays, it seems that the same market tools cannot be applied in all countries in the same way because of different conditions, GDP rate, unemployment rate, inflation rate, and especially due to the different industrial share and level of economic development in different regions.

Is it still relevant to talk about the economics of transition when the process is already more than 15 years old? Though the Central European countries and now new EU members are moving towards less and less differentiation as a category, but many transition countries have still a long way to go. The approach to these counties has changed. Attention has shifted away from broad assessments of the macro-economic situation towards micro-economic investigation based upon detailed case studies. The reaction of SMEs on all mentioned structural economic changes in both Slovakia and Hungary shall be discussed in latter parts of dissertation.

There is no unique definition and characteristics of the transitional process. Different authors or different economic conditions of the country or even of the region we have, different views on such processes we get. Introduction as well as further chapters of dissertation discusses these definitions and characteristics from different points of view. A **transition** may be also understood as a journey from one point to another [45]. It is necessary to define where one comes from, and where one is heading to. Dissertation deals with SMEs in Slovakia and Hungary affected by the transition from centrally planned economies to market economies. The catching-up process is meant chiefly to recover the pre-transition level, and later to gradually reach the average level of other 'Western' EU countries. Not surprisingly, as soon as this market environment emerged, such theories as the agency theory, the theory of incentives, the transaction costs theory, and the theory of information, were quickly tried on the cases of the countries in transition. In the beginning of transition, it has been asked whether theory might help. Various analytical frameworks have been used to account for the kind of market economy which is emerging in the countries in transition. Because transition is obviously very much affected by political factors, public choice theory and non-market decision-making are applied. As enterprise is often viewed as the core element of the transformation process, the contemporary developments of the theory of firm were developed as well. The institutional approach takes a broader view [32]. One may conclude that country in transition is a mixed economy. The government tries to avoid bankruptcies for fear of social explosion. The private sector is burdened by the existence of the public sector which crowds it out.

Table 1: Growth before and after 1989, and after transformational recession.[4]

GDP/NMP index (1989 = 100)					*Average annual growth rate (percent)*	
Country	*1980*	*1990*	*1995*	*2003*	*1980 - 1989*	*1995 - 2003*
Czech Republic	85	99	94	106	1.7	1.4
Estonia	75	92	66	101	2.8	4.3
Hungary	86	97	86	116	1.5	3.8
Latvia	69	103	51	79	3.5	3.5
Lithuania	65	97	56	81	3.9	3.2
Poland	91	88	99	135	1.0	4.5
Slovakia	85	98	84	117	1.7	4.1
Slovenia	99	92	89	120	0.1	3.9
CEE 8	*82*	*96*	*78*	*107*	*2.0*	*3.6*
EU 15	…	*103*	*111*	*132*	…	*2.6*

Source: [84].

[4] Pre-1990 growth rates for CEE 8 are based on the Net Material Product (NMP) used by for the growth accounting by the socialist countries. The 1980 figure for the Czech and Slovak republics is for Czechoslovakia.

Table 2: Average growth rates for the years 1995-2003 (in %).

Country	*Average real GDP per capita growth*	*Average labour productivity growth*	*Average consumption per capita growth*
Czech Republic	2.22	2.61	3.02
Estonia	6.57	6.55	7.32
Hungary	4.13	3.16	4.53
Latvia	7.26	8.19	7.58
Lithuania	6.25	6.61	7.10
Poland	4.18	4.76	4.49
Slovakia	3.92	3.62	3.73
Slovenia	3.83	3.32	2.64
CEE 8 weighted average	*3.95*	*4.20*	*4.32*
Austria	1.98	1.68	1.34
Belgium	1.93	1.25	1.70
Denmark	1.66	1.53	1.04
Finland	3.42	2.29	2.97
France	1.77	1.19	1.77
Germany	1.15	0.86	0.97
Greece	3.55	2.53	2.70
Ireland	6.04	3.60	4.16
Italy	1.29	0.30	1.69
Luxemburg	3.88	3.40	2.62
Netherlands	1.74	0.66	1.83
Portugal	1.83	0.17	2.09
Spain	2.77	-0.24	2.86
Sweden	2.44	2.04	2.13
UK	2.47	1.69	3.20
EU 15 weighted average	*1.82*	*0.93*	*1.89*

Source: [84].

Question concerning the countries in transition is whether it is possible to define features common to all the countries, which belonged to the 'socialistic economic system' in the East and Middle European countries. We quote three criteria: First, in such system, economic life was under the control of a single party. Second, the economic institutions were based upon collective or state ownership of the basic means of production. Third, compulsory central planning was the main coordinating mechanism, with an increasing but still subsidiary role devoted to market instruments. As a rule in all socialist countries, large-scale productive assets were state property, in industry, domestic trade, and services, following waves of nationalisation in the wake of the revolutions that had established the new regimes. Non-socialist ownership in the production sector was to be found mostly in agriculture though private farms were discriminated in terms of severe limits on total acreage farmed and supplies of equipment or materials. Outside agriculture there remained sometimes a small private sector in the form of small retail trade and handicrafts [45].

Since 1980s several variants occurred. The reforms shared similar features in all the countries, despite sometimes marked differences in their scope. Officially their aim was to grant more autonomy to the enterprise. In Eastern Europe the number of the branch ministries was reduced. In Hungary, for instance, the cut went so far as to suppress almost all central ministries. The mandatory character of the plan was relaxed. The number of compulsory indicators was cut, even to zero in the case of Hungary. But the party system remained unchanged. Only the large enterprises got more freedom of manoeuvre. The smaller units remained technical divisions of the big enterprises, and had no autonomy whatsoever. Even in the most favourable cases, the autonomy of decision-making never extended to the investment sphere. The economic transformation of Hungary has reached a critical stage. Hungary has succeeded in attracting foreign capital, and has achieved its first current account surplus in convertible currency since 1984, despite recent upheavals, but the privatisation process has reached a crucial stage. It is clear that it has been a long and difficult process, with significant repercussions for the future of the economy and profound social and welfare consequences [45].

The Hungarian model included a large decentralisation of decision-making; encouragement of private production activities; price flexibility, coupled with international openness allowing the repercussion of external prices on domestic ones; regulation of the use material and human resources through interest rates and taxes; some enterprise autonomy in the choice of suppliers and buyers. This all generated a climate of uncertainty in the environment of the enterprise [38].

The first steps on the way to the market had been made by Hungary, still under the communist rule. A bankruptcy law was enhanced in 1986. A two-tier banking system had been introduced in 1987. Small commercial banks with Western capital occurred. Company

Law and Transformation Law allowed creation of private companies with an upper limit of 30 persons employed. Czechoslovakia was rather conservative, with lip-service to the rhetoric of reform. [45]. In some ways, the most far-reaching reforms at least were a good introduction for the transition to the market. Czechoslovakia, on the other hand, had not moved far on the road to transformation. [38][5] Nevertheless the 'shock therapy' model was chosen after the collapse of the communist system. The economy was still a standard. But the current economic situation was good.

The stabilisation packages usually consisted of the following measures [55]:

- price liberalization, through the reduction of subsidies to consumer and producer prices and the deregulation of price fixing, going long with the liberalisation of domestic trade;
- balancing the government budget through increases in taxes;
- a restrictive monetary policy through an increase in the Central Bank interest rate so as to restore a positive real interest rate;
- in the beginning of stabilisation, an income policy aiming at stopping the inflation spiral;
- foreign trade liberalisation through the lifting of export and import licences and quantitative restrictions, and the permission given to all enterprises to engage into foreign trade on their own, while state foreign trade organisations were dismantled; tariffs became an active instrument of trade policy; current account internal convertibility of the domestic currency; devaluation of the domestic currency bringing it down to the market rate.

Structural measures aiming at creating a private market economy were simultaneously put on the agendas, including:

- launching privatisation, and the dismantling of the former state monopolies; introducing free competition rules, free entry on the market for business creation, and flexible labour market;
- setting up a market environment through the reform of the banking and financial sector and tax reform;
- developing a social safety net meant to replace the former all-embracing protection system;

[5] This difference in the economic development between Hungary and former Czechoslovakia can be explained by the existence of centrally planned, state-owned and party-controlled economy in former Czechoslovakia. External accounts were balanced, the economy was growing slowly. Prices were stable through price control.

- initiating an industrial policy so as to identify the ‘winners’ and ‘losers’ in the industrial activities to be restructured; taking care of environment.

As J. Kornai (1994) argued, the transformation recession is combined with deep and significant changes. The economics is changing from the economics of seller to buyer market, from the economics restricted by offer onto economics restricted by demand. This direction is influenced by uncontrollable and spontaneous processes. There is a strong dependence between recession and transition to market economy so that none can be marked as a cause of another one. [41]

Structural transformation was supposed to begin at the same time as the ‘stabilisation-cum-liberalisation’ programmes. Its main building block was privatisation, which meant creating a green-field private sector, and changing formerly state-owned enterprises into privately owned ones. Privatisation may also mean making existing state enterprises, either earmarked for further privatisation or remaining in state property, work as market-oriented firms, a process called marketisation or commercialisation in Central and East European countries. Reforms of the banking and tax systems and creation of capital markets were also among the first priorities of the policy-makers and advisers [45].

Following the change of the economic and political regime and as a result of the transformation that took place from the early nineties onwards, the number of market actors multiplied and private property became predominant in Hungary and Slovakia. The enterprise size structure underwent radical changes. Small and medium-sized enterprises became the most numerous category taking over the bulk of the activities of the former large state-run enterprises.

Over the past decade, the SMEs followed the same course of development as the private sectors of other transition economies. The group of inexperienced entrepreneurs with insufficient information to find their way in the system of market economy regulations, turned into the sector of small and medium-sized enterprises, engaged in networking and applying various forms of co-operation, reducing the country’s backlog relative to the small businesses of more developed economies in several areas.

From the beginning, the development of Hungarian and Slovak SME sector took place in acute competition, so the efficiency requirement played a significant part in shaping the current enterprise structure. The SME sector became very similar to the SME sectors of less developed old EU Member States and to that of new Members, in several regards. There is a high number of enterprises of small average size (less than 5 persons employed) in the economy. The enterprise termination/foundation rate is a healthy one; the balance in the longer term being slightly positive, the total number of enterprises is only to some extent increasing. In the long-term, no further major increase seems likely in the number of enterprises, but their average size and performance will probably increase. [87]

To date, small and medium-sized enterprises play a significant role in economic and social life. They play an outstanding role in employment, contributing to more than two-thirds of private-sector employment. The SME sector is the only relevant segment of both economies that was able to generate a net employment growth over the past 15-year period. The employment structure of small and medium-sized enterprises is much more balanced regionally than that of large enterprises.

Within the group of active enterprises, the share of corporate businesses has been increasing gradually, while the share of individual entrepreneurs has been characterised by slow erosion in recent years. [87]

Politically, privatisation means taking away property from the state and creating a new class of capitalists and entrepreneurs as we recognise them nowadays in both countries. Equity considerations suggest returning property to those who have been forcibly deprived of it during the nationalisation process, or giving priority to employees for buying shares in their enterprises; or even giving away state assets to the citizens. Privatisation may be pursued for efficiency reasons. Better management may increase productive static efficiency, if these enterprises are subjects to competitive pressure. As in market economies entering into a privatisation process, the aims may be financial. If conducted through capital markets privatisation generates revenues to the state. Finally the governments may want to use privatisation as an additional instrument of stabilisation. Hungary was the only country to have entertained some illusions as to the fiscal potential of privatisation, and this is why government initially decided upon not giving away but selling off state property [45]. In former Czechoslovakia citizens were allowed to obtain shares of state companies at a symbolic nominal price. Later on, the Slovak Republic adopted a restitution law providing for financial compensation to those whose claims had not been met in kind.

In former Czechoslovakia and later on in Slovakia, two conceptions of SME creation were introduced:

- division of state enterprises with constant price and currency rates liberalisation. National Property Fund was to become their temporal owner. State enterprises had to submit to this fund their consolidation and privatisation projects. State enterprises lost their monopoly position and thus contributed to start-up privatisation process.

- direct privatisation especially on a basis of coupon privatisation that supposed to overtake two major barriers of state enterprise transformation: lack of capital and time costs of standard methods of privatisation. Finally, the second option was chosen at the beginning. [58]

Privatisation cannot be seen as achieved once the ownership of the state enterprises has been transferred into non-state hands. The former state enterprises are still burdened by old debts, have obsolete equipment, an inadequate trained management, and very often the wrong industrial specialisation. The new property rights are not yet clearly defined. The former idea from 1990 was that during the transformation period government would provide an active and selective structural policy. Finally, this idea was constantly forgotten and replaced by privatisation. The main argument for privatisation was that state officials have little information, tools and criteria in order to provide wide range of restructure policy. Not only privatisation was supposed to provide a basic change in ownership structure but it was also supposed to contribute to changes in branch structures, size of enterprises, employment structure and workers qualification as well as foreign trade structure. Privatisation influenced trade, services and retailers within the industrial production. While coupon privatisation, on the other hand, concerned big state enterprises.

Behaviour of enterprises meaningfully influenced the whole privatisation process. Managers had a lot of disposable information about the financial position of enterprises and their potential value and thus enterprises could obtain more capital. Managers could also influence the number of shares that would be for the public for sale. In both cases they influence the ownership structure, though.

The main objectives of privatisation were:

- to change the mechanism of funds allocation in the economy,
- to change the stimulation mechanism at the micro level,
- to force the enterprises to react on consumer demand and market changes,
- to lower state budget deficit and load,
- to liberate production and entrepreneurial potential in the economy from central planning,
- to make required economic restructuralisation easier,
- to allow citizens to make profits from property ownership,
- to allow citizens to buy coupons as shares from state enterprises within the coupon privatisation for minimal price. [29, 60]

In the beginning of the transition there were hopes of a large involvement of foreign capital into privatisation. These attitudes developed foreign direct investments. The Czech Republic, Poland and Hungary have become three countries with the largest share of foreign investments. These investments have become a powerful engine of modernisation [38].

The lack of domestic capital soon emerged as the major stumbling block of overall privatisation, both big and small. The main point to answer, though, was how to mobilise savings for productive use. This raises the question of financial mobilisation.

The EU accession of Hungary and Slovakia is a great tribute to a successful transition from a centrally planned economy to a robust, fully functioning market economy, deeply integrated into the European economy.

The conditions for the transition were more favourable for Hungary since the country had the region's most liberal economy before the collapse of the Iron Curtain. Many steps have been taken toward a market economy before the political turnaround. Hungary was the first country in Central and Eastern Europe to apply for membership of the EU. Hungary has been a member of the OECD since 1996 and a full member of the NATO since 1999 and joined the EU on 1 May 2004. [84][6]

Change in the production and branch structures was connected with further two changes. First, the property rights had changed and a huge number of private undertakings and SMEs emerged. Big state enterprises were usually divided into small separate units. This process was more intensive and complex with significant impacts on the whole economy and all citizens and enterprises in transformation recession than in common market economic conjuncture cycle. Privatisation was concerned to be the main element to overtake the recession and for the growth recovery. This statement would be rather simplification and misconception of understanding of real dependence. From long-term point of view, spreading out of private sector, privatisation of former state assets and setting stronger financial discipline can increase the efficiency of the economy. From short-term point of view, privatisation is in opposite, because it increases the unemployment, decreases demand and contributes to recession. That was one of the greatest post-socialistic dilemmas. [41]

Even worse was the situation for state enterprises awaiting for their privatisation. Almost all investment activities were paralysed. We may argue, as a result of upper thoughts that:

[6] According to its convergence program Hungary's Euro-zone accession was eventuated in 2010. Though, because of several reforms that are still to be provided and realised and applied public expenditures within several economic sectors, Hungary's accession into Economic and Monetary Union is expected only after 2013.

- investments support the necessity to fasten the property ownership change. On the other hand, the process of sale should never be the main criterion. The requirement to discuss possible contributions of new owner was often forgotten, e.g. creation of new working places.
- privatised enterprises were not always in perfect conditions, they usually needed reorganisation.
- enterprise managers were not always stimulated to provide these activities in order to sustain firm in the best conditions as possible.
- motivation to invest is bigger in private SMEs comparing to state enterprises. It is restricted by uncertainty at the market, by backward financial sector and unwillingness to borrow capital, though. Weak capital market, taxation burdens and high interest rates are also the obstacles in SME development. Getting over these unfavourable circumstances was a key moment in reducing the recession. [41]

Since 1990, the European countries in transition have received large capital flows in the form of foreign direct investments and portfolio investments. The main driving force was obviously the privatisation. These countries soon became the target of multinational corporations (MNCs) and became integrated in their worldwide strategy. The usual motivations for the FDI is the market potential of the country, low costs, and geographical determinant. The new variables that motivate foreign companies to invest in transitive countries also these days are also low country risks due to the EU membership, tax regime (usually lower taxes than in domestic country), and trade policy of the country. Such big corporations lure, on the other hand, further small investors who establish new subsidiaries and create new labour opportunities both directly or indirectly via supply services.

Final effect of these FDIs is that the most successful Eastern European countries are also the most integrated into the globalisation process. First, these countries are selected as an export base even when the domestic market is narrow. Second, the cost considerations tend to become essential, and hence the host country cannot afford to let its real wages increase in comparison with other countries, though this consideration tends to become less important once a critical mass of FDI is attained. Third, the most successful countries attracting FDI are included in multinational companies' global networks. The host countries usually provide for the big FDI greater protection, they offer tax holiday or train labour force.

The FDI increased the living standard, they raised GDP, decreased the level of unemployment, they contributed to the financial stability of the country. Second, FDI serve as a driving force for restructuring. Restructuring is considered to be as an essential motivation for FDI in the countries in transition. The foreign partner brings a managerial culture and fosters the development of new technologies. Domestic enterprises, in order to sustain competitive and prosper, tend to innovate and spend more money on research. Will these acknowledgments be compatible with those taken from practical research of domestic (both Slovak and Hungarian) SMEs [85]?

Unfortunately, not always the long-term aims of the local or national governments of the countries in transition go hand in hand with the interests of big investors. Sometimes, they are contradicted. When foreign investor primarily looks for his gains from lower costs, an increase in these costs may prompt him to settle in another location. They may even reduce the employment, when e.g. huge hypermarket chains push out of the market small food stores because of selling the products at low prices that are often lower than costs of the retailers. Such big investors may even try to reach a monopoly position on the market. There is thus a difficult balance to be maintained between the wish to be incorporated into the global economy with both its positive and negative consequences and the desire to keep control over national industrial and social policy.

Experts have tried to assess in how many years the various countries in transition might reach the EU level. The estimates range from 20 to 30 years to converge to the per capita income level with annual rates growth in the range of 4.5 to 6 per cent (assuming EU countries would grow by annual rate of 3 per cent). Such forecasts do not take into account external shocks, or reversals in policies [45].

Should we confront chosen strategies of the centrally planned economies transformation on market economy with empirical knowledge, we can provide these conclusions:

- speed and length of transformation depends on coordination of goods and services creation (liberalisation of prices and internal currency convertibility) with ownership transformation (capitalisation and commercialisation) of state enterprise sector and minimalisation of time difference among these dependent system elements decisive for creation and functioning of consistent market mechanism,
- in a light of obtained empirical information, the fastest way of ownership transformation turned out to be complex capitalisation and commercialisation with further direct privatisation.

- consequently, systematic basis for the application of markedly conform selective economic policy (mainly fiscal policy) was created, e.g. temporal taxation holidays, grants, favourable interests, etc.
- speed of revival and renewal of the economic growth depended on pace of capital market creation and connection on a basis of enterprise capitalisation allowing both reallocation of existing capital and entry and creation of new capital.

In the first stated hypothesis I supposed that the major influence on SME establishment in both analysed and compared countries had the privatisation of the state property and legislative changes that would allow spreading out of the market economy in practice.

Thesis 1: From all mentioned facts and figures in Chapter 2.3 I confirm the first hypothesis and I state that: the structural transformations that included privatisation of big state enterprises, taking away property from the state and creating of a new class of capitalists and entrepreneurs were the major elements in SME creation. Former Czechoslovakia representatives decided also for a coupon privatisation and thus they allowed all citizens to participate on shares and created value. The main objectives to launch privatisation and thus to make a potential for the entrepreneurs' creation were: (1) to change the mechanism of funds allocation in the economy, (2) to support the stimulation at micro level, (3) to force the enterprises to react on demand and consumer behaviour instead of fulfilling the central plans, (4) to lower state budget deficits and bring new taxation revenues, (5) to liberate production and entrepreneurial potential in order to satisfy the ever changing need of consumers for brand new products, (6) to make the economic re-structuralisation easier, and (7) to allow people to make profit. Privatisation together with legislative changes such as bankruptcy law, price liberalisation, reform of financial and banking system consisting of central and commercial banks, taxation and accounting reforms, liberalisation of whole market have become the main driving force for latter foreign direct investments.

2.4 Position and roles of SMEs

2.4.1 Definitions and characteristics of SMEs

By **enterprise** we mean a privately owned profit-oriented business organisation with independent market contacts, whose core activity is production (income-generation) in the statistical sense. [67, 79, 88, 89]

The term **company** is used synonymously with enterprise. For business partnerships and many other types of organisations, the company form is obvious, but Hungarian and Slovak legal regulations treat the sole proprietor registered in the Register of Companies, basically, as a single-member business. [67, 79, 88, 89]

The following company organisation forms are regarded as enterprise:

- sole proprietorship,
- every form under the Companies Act (general partnership, limited partnership, joint venture, limited liability company, company limited by shares), and
- co-operative.

One group of organisations will be excluded from the concept of "enterprise" for formal organisational reasons. There are several types of organisations that are allowed to pursue business activity, but do not necessarily do so. The first to be assigned to this category are non-profit organisations, viz. public benefit companies, societies, public bodies, foundations and public foundations. Although business activity is not the original purpose of non-profit organisations, in Hungarian and Slovak practice, some are primarily involved in that. Non-profit organisations "doing business" should in principle be assigned to the enterprise sector, but no such distinction can be made in practice. Therefore, non-profit organisations will not be included among the enterprises.

Certain types of organisations include business and occasionally also entrepreneurial units, but their activities are very limited in some respects, they are not assigned to the enterprise sector. The following organisational forms are also excluded from among the SMEs:

- local and central budgetary organs,
- chambers, societies – including employers', employees' and professional interest representation organisations,
- social security,
- investment and guarantee funds.

Small and medium-sized enterprises in Hungary were defined under Act XCV of 1999 on small and medium-sized enterprises and the promotion of their development. Accordingly [88, 89]:

(1) An enterprise shall be considered a small and medium-sized enterprise if its total staff is less than 250, and its annual net turnover does not exceed HUF 4 000 million, or its balance sheet total HUF 2 700 million, and, furthermore, it conforms to the conditions under point (4) below.

(2) An enterprise shall be considered a small enterprise if its total staff is less than 50, and its annual net turnover does not exceed HUF 700 million, or its balance sheet total HUF 500 million, and, furthermore, if it meets the conditions under point (4) below.

(3) A micro-enterprise is a small enterprise with a total staff of less than 10.

(4) An enterprise shall be considered a small and medium-sized enterprise if the property share of the state, the municipality or companies beyond the scope of point (1) above – based on equity or voting right – does not exceed separately and jointly 25%.

The above Act was amended by Act XXXIV of 2004 on small and medium-sized enterprises and the promotion of their development in two steps, first as of 1 May 2004, the date of Hungary's accession to the EU and then as of 1 January 2005. The net turnover and balance sheet total limits applicable to small and medium-sized enterprises were altered on both occasions [88, 89].

By the way, the Act applies two SME definitions: one specifies in detail enterprises eligible for subsidy, while the other focuses on the CSO and APEH data provision requirements. The present report adheres to the latter, and groups enterprises on the basis of size expressed in terms of staff headcount into size categories of 0–1, 2–9, 10–49 and 50–249. The tables cover the category of large enterprises with 250+ staff also.

With effect from 1 January 2005, the Act defines enterprises eligible for subsidy as follows [88, 89]:

(1) An enterprise will qualify as SME if its total headcount is less than 250, and its annual net turnover does not exceed EUR 50 million, or its balance sheet total does not exceed EUR 43 million.

(2) Within the SME category, the following will qualify as small enterprise: total headcount under 50, and annual net turnover or balance sheet total does not exceed EUR 10 million and, furthermore, it complies with the criteria under Paragraph (4).

(3) Within the SME category, the following will qualify as micro-enterprise: an enterprise with a total headcount under 10 and an annual net turnover not exceeding the EUR 2 million, and, furthermore,

(4) An enterprise will not qualify as SME if the state or the local government owns, directly or indirectly, a share in it exceeding – on the basis of the capital or the voting rights – separately or jointly 25%.

Different definitions identify different circles of small and medium-sized enterprises and, consequently, the sector is characterised by different resources, performance etc. indicator values in each case.

The new definition was introduced in two phases: the transitional period lasted from Hungary and Slovakia EU accession to 1 January 2005 and the final regulation came into force on 1 January 2005, when the categories in use in the Union changed as well, given the fact that financial indicators figuring in the Hungarian and Slovak definition must match those in the effective EU Recommendations (i.e., Commission Recommendation (EC) No 96/280 of 3 April 1996 (OJ L 107) until 31 December 2004, and Commission Recommendation (EC) No 2003/361 of 6 May 2003 as of 1 January 2005). The new definition implied the re-classification of almost 1 000 enterprises in 2005 – hence so many more have access to the relevant assistance/financing schemes. The relative proportions of micro-, small and medium sized enterprises shifted as well. Essential differences between the old and the new definition include the more precise definition of micro-enterprise; the elevation of the balance-sheet-total and turnover limits applicable to small and medium-sized enterprises and the introduction of more specific criteria to distinguish linked enterprises than the previous autonomy criterion based on a 25% state, municipal or other non-SME holding. [88, 89]

2.4.2 Brief overview of the SME position in Hungary and Slovakia

Development of small and medium enterprises has been declared as one of the priorities of the economic development of both Slovak and Hungarian economy. An important factor for this context is the creation of an adequate business environment, and this assumes making the legislation simpler and more transparent, reduction of administrative and tax-related burdens, reinforcement of supporting infrastructure, and improved access to capital [80].

While the SME sector is central to both the theoretical understanding and practical functioning of market economies, simplistic assumptions about the "self-organizing" features of markets resulted in insufficient attention to the conditions necessary for successful development in transition economies. The small enterprise sector will not by itself create successful economic growth, however. This is especially evident as soon as attention shifts from retail and neighbourhood-level services to directly productive small enterprises. SME sector success requires both active support services at the local level and the survival, revival or development of a healthy large enterprise sector as supplier of inputs, output market, provider of various social and technical externalities, and also (unexpectedly) as source of individual entrepreneurial leadership.

Local and regional governments have a central role in stimulating growth of various types of business activity. This includes creation of a local finance system based on credit cooperatives to overcome the SME credit famine and stimulate local saving-investment cycles, as well as directly para-entrepreneurial functions (including equity ownership), all generally consistent with the "local developmental state" growth model.

Despite the centrality of the small and medium enterprise sector in both the theoretical understanding and practical functioning of market economies, little attention has been paid to the conditions necessary for its new or expanded development in transition economies. This omission partly reflects assumptions of market automaticity – that spontaneous processes can be counted on to create new, viable entities to fill the interstices between large organizations. The theoretical constructs economists use to describe and analyse small movements within established market systems unfortunately do not offer much help in deciding which institutions to adopt or how to construct them *de novo*. The SME sector is implicit in all free-market reasoning and central to assumptions about the spontaneous developmental capacities of markets and market systems [45].

Understanding the possibilities and limitations of the SME sector proved difficult in this context, but it is important to look at both the realities of the SME sector and the unfortunate interactions of SME policy with transition ideology. The complexity of creating and sustaining SME development becomes evident as soon as attention shifts from the more obvious retail and neighbourhood-level services to directly productive small enterprises.

Unless surrounding large enterprises have been successfully commercialised (meaning that privatisation has either been delayed or done in a way that does not sever existing working relationships) and overall demand conditions are not severely restrictive, no significant and sustained SME growth can be expected.

From a theoretical perspective, SMEs have several advantages over large state owned enterprises (SOEs). Incentives for both managers and workers in SMEs tend to be clearer and stronger than in larger organizations. Governance problems are less significant since in many cases the managers and owners are the same people, and small size allows owners easily to monitor the performance of managers and workers. Under the special conditions of the transition economy there are several additional advantages. Many entities classified as 'emerging' SMEs are not really new, but had a pre-transition existence as parts of large, usually horizontally integrated, service, craft and distribution SOEs or cooperatives. The 'new' sector of relatively small organizations is thus a mixture of many privatised sub-units of SOE, entirely *de novo* entities and surviving pre-transition SMEs. Many have or could take on cooperative forms.

What are the other advantages of SMEs comparing to those large enterprises? First, we may conclude that small firms appear to have greater flexibility and potential for innovation, which could be especially important in the unsettled conditions of the transition period. To the extent that the SME firms produce the same products or services as SOEs, they reduce monopoly tendencies.

Second, higher productivity is also likely in those product areas where there are no or few scale economies (e.g., services and niche manufacturing processes).

Despite these potential competitive advantages, SMEs confront a series of barriers that raise operating costs and threaten their economic viability. Taken from theoretical sources it is obvious that they face higher costs for and more limited access to credit and other inputs, they have greater difficulty penetrating export markets and they are vulnerable to harassment by criminal gangs. The criminalisation of everyday life in many transitional societies has been the subject of much sensationalized discussion, but it is a serious and complex problem.

Question when transition is over is difficult to be responded. There are many different opinions. The transition might be over when the countries in transition reach a functioning market economy. Though, the transition not only leads from plan to market but also from underdeveloped to developed one. In fact, while transition from plan to market may be considered as more or less completed, transition from a low level and a distorted pattern of development to the average level and pattern of the former EU-15 is largely overlooked. The transition process has been sharply different from place to place, reflecting strong path-dependent features – in which actions taken at one time have effects and implications that cumulate through time, enabling and foreclosing options in ways that are not always easy to understand. If SMEs could survive, and even in some cases thrive, under fundamentally 'hostile' old system conditions, it is at least superficially puzzling that their experience in transition has been so difficult and at best mixed. Clearly institutions matter but not in any simple sense of the words. At the micro-levels, it is not the existence of a legal code and court system, but the broad acceptance of this system as the actual forum in which disputes are to be settled. It is not the existence of a wholesale distribution network, but the terms of access to this system by small-scale producers. At the macro-levels, the foundation of small productive enterprises produces little or no ultimate effect if their putative customers are in a fiscal crisis that inhibits or prevents expenditures. This is true regardless of whether the demand reduction is for inputs by SOEs (fragmented and damaged in a hasty privatisation process) or for consumer goods by the general public Programmes designed to provide direct assistance to SMEs often end up mired in corruption, have high overhead costs and ultimately serve other than announced programme interests.[7]

The SME sector must simultaneously absorb resources and workers from the large enterprise sector and at the same time help create a labour market situation in which the process of reorientation and fundamental reorganization of the large enterprise sector can be carried out without threatening social peace. In addition to slowing down the restructuring process, the failure to develop the SME may increase the volume of required transfer payments for unemployment, early retirement and other programmes and (under certain fiscal policy assumptions) crowd-out investment and other employment creating expenditures. The complexity of creating and sustaining the development of SME sector in an emerging transitional economy becomes evident as soon as attention shifts beyond the more obvious retail and neighbourhood-level services and considers directly productive small enterprises. Figure 2 shows a continuum of forms of individual activity within the borders of small- and medium-sized enterprise sector.

Figure 2: Comparison of activities provided by different forms of enterprises.

Survival/small	**Trading proprietorship**	**Entrepreneurship**
Low income	Maintenance orientation	Systemic entrepreneurship
Trading only	Niche entrepreneurship of a generally transient type	Economic entrepreneurship (classical)
No cumulative growth	Surplus generated predominantly for	Long-term goals Capital accumulation
Health damage	personal consumption purposes	Personal austerity in order to build business

Source: [45].

[7] The analyses of 'emerging' SMEs in the transitive economies, their potential to obtain financial capital, and their comparison with state owned enterprises (SOEs) were elaborated in works of Wedel (1998), McIntyre (2001) and Glinkina (2002).

The point has already been made above that much self-employment falls into two diametrically opposite categories. On the one hand are *low income/high cost personal survival strategies*. These often involve petty trading in a form that requires a way of life that causes high risk of health damage and provides very low income. At the other extreme are various *middle-high and high-income professionals* such as doctors, lawyers, notaries, plumbers and electricians. It is thus difficult to characterize the self-employed sector in any simple way. What is clear is that neither of these extreme but prevalent cases matches the hoped for dynamizing force implied in most descriptions of the role of the SME. Thus we need to look with care at reported small-scale activity to get a realistic sense of what lies behind the numbers.

Much of the transition period activity that is characterized as evidence of successful development of the SME actually fits within the proprietorship rather than entrepreneurship category, recognizing that there is an ambiguous border between the two and that individuals can obviously evolve or devolve from one to the other, possibly more than once.

The policy of SME promotion was directed towards further improvement of the business environment after the EU accession, and thus to prepare the SMEs for successful operation in this market. Reduction of tax burden on enterprises could positively manifest itself through enhanced inflow of foreign investments to initiate the development of the countries' economy. Linked to big investors, also the sector of small and medium enterprises could benefit from this, through subcontracting and provisions of services to the dynamically developing firms. The share of small and medium enterprises in the Slovak and Hungarian economy is currently already comparable with those in developed countries: SMEs account for 99% of all enterprises. There was an increase in all types of small and medium enterprises last year, including natural persons and legal entities, and also their share on employment increased [70, 87, 88].

Despite the above-mentioned positive trends, there are still certain negative aspects in the development of the business environment. Among them, we should mention the burden associated with contribution to funds, poor law enforcement, excessive administrative requirements on doing business, market distortions and distortions concerning property records, numerous superfluous environmental standards, persisting price regulation, existence of legal privileges in business as well as increasing regulatory burden in connection with the approximation of Slovak and Hungarian legislation with the EU law.

The industrial sector and especially the SMEs have a very significant position in the future development of both economies. The small and medium enterprises have the highest share on creation of new labour opportunities, and therefore it is necessary to support constantly those technologically and pro-export orientated enterprises and their managers.

Plenty of existing companies have to increase the quality of trade activities in order to become competitive. This area includes mainly the implementation of new technologies. After the EU accession by Slovakia and Hungary in May 2004, many SMEs began to focus on spread export markets, creation of brand new products and processes not only to survive, but also to prosper and increase their efficiency and effectiveness.

The governments support creation of new enterprises with potential to prosper for a long time, those trying to innovate and implement environment-friendly technologies by securing better infrastructure and information and advisory services, e.g. financial and technologic advisories, or by organizing the workshops, etc. Support and development of an innovative environment is especially in the area of industrial development and research, technology transfer, know-how, innovative products and progresses. The aim is to transfer the SMEs on innovative enterprises at the regional level by supporting existing innovative centres for implementing the research into practice. Implementation of the systems of quality will allow constructing of accreditation and certification system focused on increasing the production quality and opportunity to connect with the international cooperation [80].

2.4.3 Barriers for the SME development

Development of SMEs is slowed by the existence of many barriers that entrepreneurs have to face. Most of developed countries with market economy try to avoid these barriers in order to create well functioning market environment. We can distinguish two sorts of barriers [39]:

- external,
- internal.

External barriers of development are those affecting the entrepreneurial subject from outside (i.e. restriction of the economic policy, failures in legislation, underdeveloped market environment). There exist many specific external barriers from the point of view of establishment and development of SMEs:

- unstable macroeconomic conditions that are closely related to macroeconomic imbalance of the country,

- obtaining of financial means which is connected with problems of financing and underdeveloped network of institutions offering capital for creation and development of SMEs,
- high financial load connected with high taxation burden,
- legislative barriers resulting from often changes and amendments,
- information barriers with missing information system especially in the area of marketing and cooperative relations, connection to business and industrial chambers,
- educational barriers meaning few educational systems orientated on entrepreneurs' education.

Internal barriers result from the entrepreneurial subject itself. Most of people operating in a business have lack of knowledge and experiences with the private business. This results from radical changes of the conditions for the individual. Only those who already performed in the competitive environment can react positively to these changes. The internal barriers resulting from these changes are:

- lack of motivation caused by the economic policy and legislation gaps,
- threat of risk connected with its existence,
- low level of specific knowledge, mainly PC skills, foreign languages, marketing, etc.,
- lack of own capital that does not allow to realise perspective projects.

The legal and regulatory framework is of major importance to entrepreneurs. Especially transition economies score weak here in comparison with other countries. The administrative burdens are also one of the major constraints for SMEs. The legal system is not just the legislation but also on how the legislation is implemented in practice.

Compliance with laws and regulations incurs costs for enterprises. We can distinguish between two types of costs. Firstly, the costs to comply with the rules and secondly the costs of preparing the documents, administration, etc. that show that the company complied with the rules. The latter are usually called **administrative burdens**. They are defined as efforts that enterprises have to make in order to comply with the legislative obligations. Moreover, administrative burdens represent costs in time and money to the community, which has to deal with them, including private companies and citizens. Indicators of administrative burdens include: number of procedures, number of forms to be completed, number of institutions involved, quantity of information required, duration of procedures, frequency of information, fees and charges, costs for required documentation, expert advice, delays.

Another barrier for the SME development is considered to be **corruption**. It can be defined as the misuse of public officer for private gain. It encompasses abuses by government officials such as embezzlement and nepotism, as well as abuses linking public and private actors such as bribery, extortion, influence peddling, and fraud. Corruption arises in both political and bureaucratic offices. It also creates unfair competition.

Corruption is usually measured by the Corruption Perception Index. It is a composite index, making use of surveys of business people and assessments by country analysts.

Table 3: Corruption Perception in V4 countries in 2000-2005.

Year / Country	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**
Hungary	5,2	5,3	4,9	4,8	4,8	5,0
TheCzech Republic	4,3	3,9	3,7	3,9	4,2	4,3
Slovakia	3,5	3,7	3,7	3,7	4,0	4,3
Poland	4,1	4,1	4,0	3,6	3,5	3,4

Source: [57][8]

According to the CPI, The Slovak Republic and Poland are one of the most corrupt countries in Europe. This means that Slovak and Polish entrepreneurs face severe problems in doing business in general and that they have a competitive disadvantage towards entrepreneurs in the other EU countries.

Establishing a company is another barrier in SME development. The following Table 4 provided by the World Bank illustrates the main indicators. They include:

- all procedures required to register a firm,
- average time spent during each procedure,
- official cost of each procedure, and
- the minimum capital required as a percentage of income per capita.

[8] Detailed description of the CPI methodology is available on www.transparency.org

Table 4: Indicators for starting a business.

Indicator / Country	**Procedures (Numbers)**	**Duration (Days)**	**Costs (% GNI per capita)**	**Min. Capital (% GNI per capita)**
Hungary	6	38	22,4	79,6
The Czech Republic	10	40	9,5	39,0
Slovakia	9	25	5,1	41,0
Hungary	10	31	22,2	220,1

Source: [63].

Any entrepreneur should be able to easily, quickly, and inexpensively open and/or close his company. This indicator shows the extent of the difficulties associated with opening or closing a company. Changes in legislation in transitive economies of V4 countries should allow entrepreneurs to go quicker through the whole process than before. The indicator "Costs of establishment" takes into account official costs related to the establishment of a company but excludes consulting fees, management time spent or bribery. Costs are measured as percentage of Gross National Income (GNI) per capita.

The development of business environment for the development of SMEs confirms that gradual improvement of legislative structure in the interest of the elimination of non-market barriers and strengthening the competitiveness of business entities remains one of the principal prerequisites for the raising of the performance of both economies. The economic policy of the government and improved availability of information, as well as the developments in trade and labour legislation are nevertheless perceived positively by the enterprises. Though, there is still plenty to be done in the area of legislation, tax burden, excessive administrative requirements when establishing the company, quality and safety standards, persisting price regulation, etc. As an example of the excessive administrative requirements, any entrepreneur wishing to start up business in Slovakia has to take 10 different steps, while in Hungary only 5 ones. OECD average is 7 days to establish a company. The entrepreneurs expect to reduce this administrative load after the EU accession. When it comes to number of days it takes to establish a company, 98 days are needed in Slovakia, comparing to 65 in Hungary and OECD average of 30 days [70].

Closing the business is of key importance. Often entrepreneurs meet success only in their second or third attempt. Therefore entrepreneurs should be able to close down a business effectively in case of failure and be able to restart as soon as possible.

The SMEs are considered to be the most flexible, most effective, most progressive, and thus most important part of the economy. That is the reason why the EU countries as well as less developed ones focus closely on SMEs and regularly approve the directions for their further development. Their support has become part of the whole economic strategy. The statistics say that the share of SMEs on total number of enterprises in the developed EU countries is 80 – 99%, their share on employment 45 – 75%, and they produce 40 – 60% of GDP. The SMEs are capable to cope with demand fluctuations. The high share of qualified specialists and less formal, more direct labour relations, allow higher resistance of SMEs towards the changes in employment in the enterprise [70].

It is necessary to distinguish between the growth of employment in existing and launching enterprises. The launching entrepreneurs meaningfully contribute to growth of employment and offer important mechanisms for the re-entry of unemployed on labour market; they also support trading activities in the regions with low share of tradesmen and business subjects. Therefore it is important that government support them from the long-term point of view.

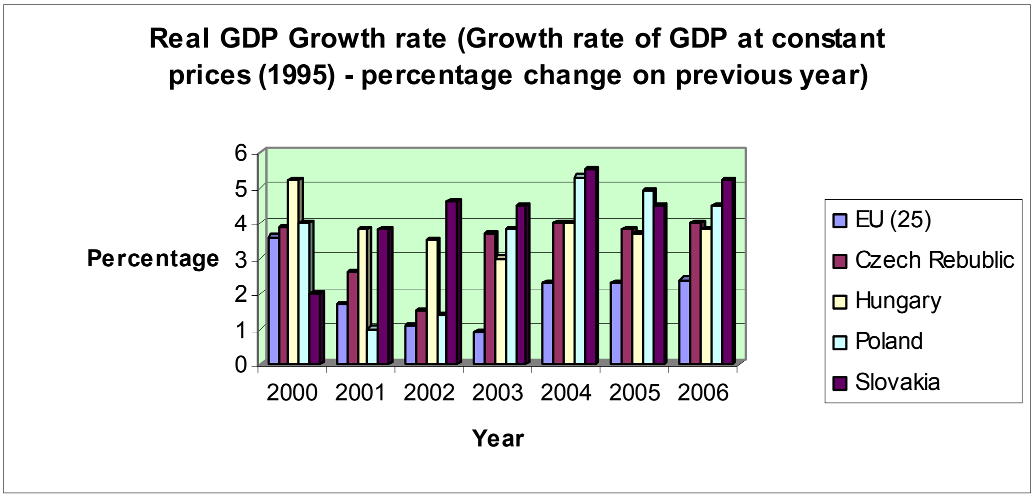
The needs of small and medium enterprises saturated especially domestic development and implementation firms that knew well their customers and took the advantage from the uninterested multinational companies. The globalisation has strengthened (also due to the EU accession), the SMEs are dynamically developing and have higher requirements for the business management, on its growth and further expansion.

2.4.4 Macroeconomic indicators influencing the Slovak and Hungarian SMEs

Macroeconomic factors influence the competitiveness of small and medium enterprises in Hungary and Slovakia. I compare these with the data of EU, moreover with the data of the other two countries of Visegrad Four. The key question is to find out whether SMEs positively or negatively contribute to improved macroeconomic indicators within the analysed period. In our second hypothesis I assume that SMEs in their every day performance increase GDP and employment rate in the country and thus they decrease the unemployment level, balance the price level, improve value added with new technologies, etc.

One of the influencing factors of competitiveness of companies is that they are working in a country with growing, stagnating or possibly declining economy. The economic growth means the macro level quality change of economic system. Gross domestic product (GDP) is a measure for the economic activity. The calculation of the annual growth rate of GDP at constant prices (1995) is intended to allow comparisons of the dynamics of economic development both over time and between economies of different sizes. The growth rate is calculated from figures at constant prices since these give volume movements only, i.e. price movements will not inflate the growth rate. The growth of real GDP in Hungary shows decrease until 2003 but 1% increase can be seen in the next year. The data referring to 2005 and 2006 on the diagram were only forecasts but these predict an increase below 4%. The situation in Slovakia is slightly different. GDP growth has been over 4% since 2002. This highly exceeds the average that refers to 25 countries of European Union but it cannot reach the level of the other three examined countries that can disadvantageously influence the competitiveness.

Chart 1: The growth of real GDP in percentage of last year.



Source: [80].

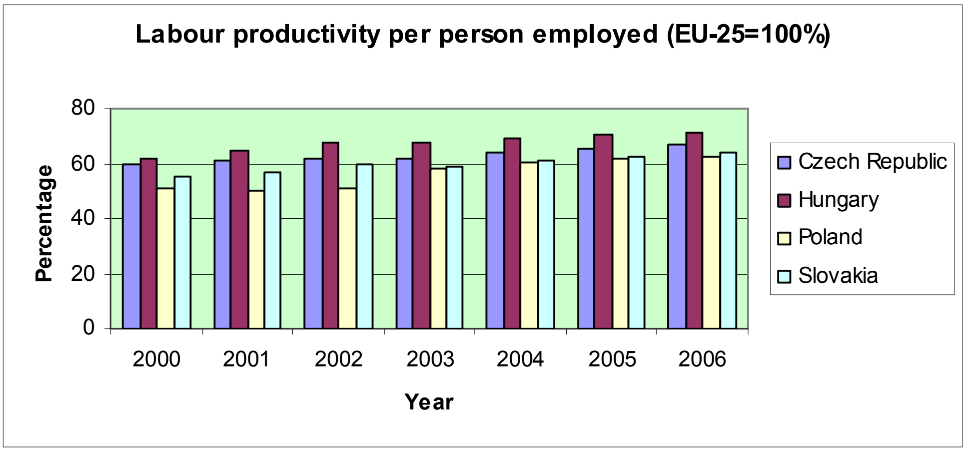
Productivity of SMEs is also a key indicator of their competitive position comparing to the EU or remaining V4 countries. The productivity projected to the number of employees can play a role in development of competitiveness but we cannot draw far-reaching conclusions only based on this index because the productivity is influenced by a lot of hardly measurable factors for example the level of mechanization and automatization.

Although the productivity of Hungary and Slovakia is behind the EU average, it shows slow but continuous increase. In respect of competitiveness the data of Hungary surpass the productivity of other countries of Visegrad Four.

In respect of a country we can approach the relationship of FDI and competitiveness especially by the influence of foreign direct investments of capital that effects the economical growth. In company respect the most important characters are the multinational companies that accomplish the FDI. These companies do the most research and development. By that, they are the most important sources of technological transfer.

The influence of technology transfer can appear in the improvement of productivity, change of industrial structure, increase of expenses of research and development, transformation of structure of export and import and the change of human capital.[9]

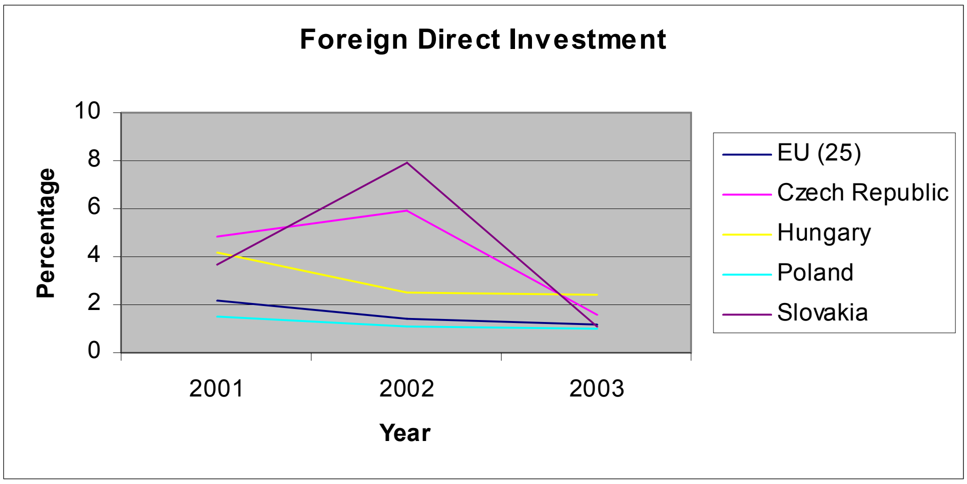
Chart 2: The change of productivity related to employees.



Source: [80].

The data referring to the FDI index cover a quite short period, reliable data can be found only between 2001 and 2003. The foreign direct investments of capital show decrease in Hungary in the examined period but exceed the average of European Union in those three years. Slovakia became attractive for the foreign investments of capital. The FDI index of Poland stayed below the average of European Union recently.

Chart 3: The change of direct foreign investments of capita.



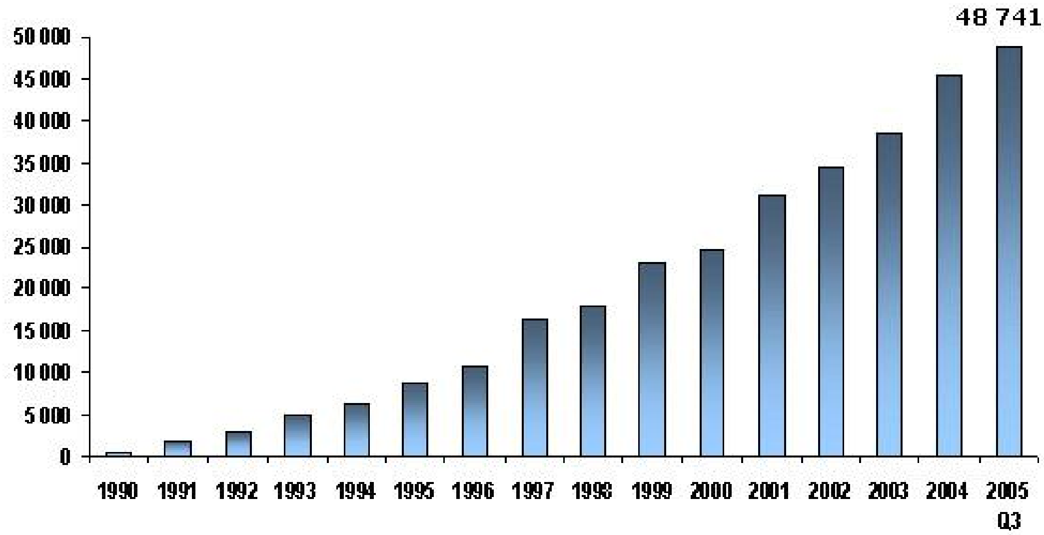
Source: [80].

[9] Further elaboration and analysis of the influence of technology on SME success can be found in works and scientific paper of Sass (2003).

Since the beginning of the transition to democratic market economy at the end of the 1980s, Hungary has attracted a steady stream of foreign capital, well balanced across the various sectors of the economy. Hungary, a country of 10 million inhabitants, can currently boast of having attracted FDI of approximately 50 billion Euros to date.

In the early 1990s, market-based privatisation (a unique phenomenon in the region at that time) was the main incentive for foreign investment - although even then investments in new industrial facilities were becoming increasingly frequent. Today, there are new incentives for foreign businesses and a new direction of incoming capital.

Chart 4: Cumulated FDI in Hungary 1990-2004, in million euros.



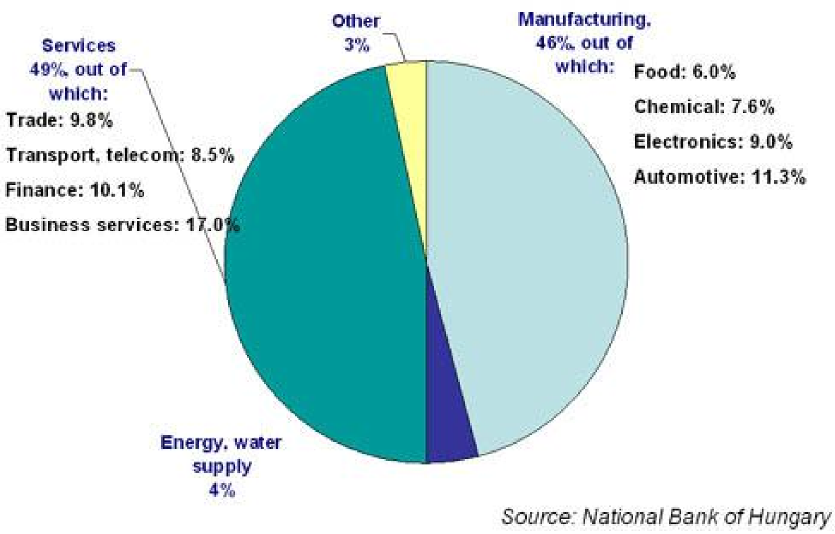
Source: [81].

While privatisation is still in progress in other central European countries, Hungary has been focusing more intensively on the introduction of advanced technologies and innovation into production of goods representing higher added value. Investment in the automotive sector, research and development, shared services operations and logistics has become especially important. Today, not only have a number of largest multinational manufacturers and service providers established their facilities in Hungary, their major international suppliers have also come and brought their subcontractors with them. In Hungary presently there are more than 25,000 companies with foreign participation.

Hungary’s attractiveness as an investment location and thus the volume of foreign direct investments into Hungary has been significantly enhanced by the accession to the EU which also resulted in the increasing volume of profit reinvestments within FDI. Even after privatisation had practically come to an end in Hungary, FDI inflows show a balanced confidence of foreign investors in the country's business environment and in good returns on investment. Hungary is one of the most attractive places in the Central and Eastern European region for upgraded and high-value added investments. Hungary's industrial production growth has accelerated since 2002. In 2004 8.3% growth rate has been achieved which is approximately three times higher than in 2002. For 2005 and 2006 a yearly growth rate of 7% was expected, mainly supported by renewed robust foreign demand, especially for computers, telecommunications equipment and motor vehicles.

Hungary's export industry experienced an outstanding increase in 2004: the volume of exports increased by 18.4 % exceeding the rate of imports growth (15.2%). In 2005 and 2006 the export grew at a more moderate rate (11%) which still exceeded those prior to 2004. Three-fourth of Hungarian exports find their market in the enlarged EU.

Chart 5: FDI Stock in Hungary by Sectors.



Source: [81].

In order to determine the significance of SMEs both in Slovakia and Hungary and thus to confirm stated second hypothesis, I provided the analysis of relevant data concerning the SME influence on movement (growth or decline) of the macroeconomic indicators such as GDP rate, unemployment rate, rate of inflation, which are the most important and appropriate indicators of the country's economic development. I compared the SME growth significance for GDP growth in both countries, SME significance on increasing the total employment, and how the share of SMEs on gross production and export was related to GDP growth. Numbers and data were collected from relevant statistics of Hungary and Slovakia and thus own calculations provided.

Table 5: Comparison of SME growth to GDP growth in Hungary.

Year	SME growth	GDP growth
2001/2000	1.028	0.739
2002/2001	1.024	0.905
2003/2002	1.022	0.871
2004/2003	1.019	1.279
2005/2004	1.018	0.872
2006/2005	1.015	1.011

Source: Own calculations on a basis of statistical data from [81].

If we compare the appropriate data taken from the statistical evaluations we see that development of basic macroeconomic indicator, GDP that determines the development and success of the economy as whole, clearly influences the growth or possible decline in number of SMEs in Hungary. The more GDP decreased within the analysed period, the less number of active SMEs performed at the market. This is a constant movement towards decline of number of SMEs despite the exemption in 2004 and 2006, when GDP grew but it did not stop decline in number of SMEs. Since the economic environment improved not only in EU but also in Hungary in 2006, a switch was expected in trend of SME development.

Table 6: Comparison of SME growth to GDP growth in Slovakia.

Year	SME growth	GDP growth
2001/2000	1.037	1.032
2002/2001	0.978	1.041
2003/2002	1.107	1.042
2004/2003	1.106	1.06
2005/2004	1.04	1.075
2006/2005	1.101	1.081

Source: Own calculations on a basis of statistical data from [69, 82].

Comparing the relevant statistic data from Slovakia in Table 6 we see the positive trend in the SME development which was influenced and supported by the GDP growth in every analysed year. The more GDP grew, the better economic situation and the better conditions for providing the business in Slovakia were. Moreover, this positive trend influenced a lot of SMEs to be established what clearly identifies Table 7. The more GDP grew, the bigger share on employment of SMEs occurred. Comparing the relevant data from Tables 6 and 7 we notice positive influence of macroeconomic indicators on SME performance and thus the SMEs contribute to growth of the economy as whole. Although the growth of employment in SMEs is not constant, but with slight differences (employment grew faster until 2003, when the growth slowed down), it is a good news for the whole economy that the rate of unemployment decreased due to increased employment in SME sector.

Table 7: Share of SMEs on total employment in Slovakia.

Year	Number of employees in SMEs	Share of SMEs on total employment	Index
2000	1 141 022	0.577	-
2001	1 186 631	0.591	1.024
2002	1 245 508	0.620	1.049
2003	1 339 057	0.660	1.065
2004	1 411 358	0.695	1.053
2005	1 468 531	0.708	1.019

Source: Own calculations on a basis of statistical sources from [69].

Table 8 compares GDP growth and its significance with share of SMEs on gross production and share of SMEs on export of goods and services.

Table 8: Share of SMEs on gross production and export in Slovakia.

Year	Share of SMEs on gross production	Share of SMEs on export	GDP growth (Index)
2000	39.8	30.5	1.032
2001	40.8	31.1	1.041
2002	40.5	28.2	1.042
2003	38.2	25.0	1.06
2004	39.6	26.6	1.075
2005	41.9	32.3	1.081

Source: Own calculations on a basis of statistical sources from [69].

Table 8 also indicates the significance of GDP on SMEs if we analyse their share on gross production and on total export. The more GDP grew the greater share of SMEs on gross production and export was (mainly since 2003). The numbers within the analysed years are well comparable and indicate positive trend in SME performance and show their positive influence and significance on analysed macroeconomic indicators of the economic development.

2.4.5 Commercial enterprises in Hungary

Following the change of the economic and political regime and as a result of the transformation that took place from the early nineties onwards, the number of market actors multiplied and private property became predominant in Hungary. The enterprise size structure underwent radical changes. Small and medium-sized enterprises became the most numerous categories taking over the bulk of the activities of the former large state-run enterprises.

Over the past one-and-a-half decade, Hungarian small and medium-sized enterprises followed the same course of development as the private sectors of other transition economies. The group of inexperienced entrepreneurs with insufficient information to find their way in the system of market economy regulations, turned into the sector of small and medium-sized enterprises, engaged in networking and applying various forms of co-operation, reducing the country's backlog relative to the small businesses of more developed economies in several areas.

From the beginning, the development of Hungarian SME sector took place in acute competition, so the efficiency requirement played a significant part in shaping the current enterprise structure.

The Hungarian SME sector became very similar to the SME sectors of less developed old EU Member States and to that of new Members, in several regards. There is a high number of enterprises of small average size (less than 5 persons employed) in the economy. The enterprise termination/foundation rate is a healthy one; the balance in the longer term being slightly positive, the total number of enterprises is only to some extent increasing. In the long-term, no further major increase seems likely in the number of Hungarian enterprises, but their average size and performance will probably increase.

To date, small and medium-sized enterprises play a significant role in economic and social life. 99.9% of enterprises are SMEs [87]. They play an outstanding role in employment, contributing to more than two-thirds of private-sector employment. The SME sector is the only relevant segment of the Hungarian economy that was able to generate a net employment growth over the past 15-year period. The employment structure of small and medium-sized enterprises is much more balanced regionally than that of large enterprises. Their contribution to the Budapest/countryside and the inter-regional employment gaps is less marked than that of large enterprises.

Within the group of active enterprises, the share of corporate businesses has been increasing gradually, while the share of individual entrepreneurs has been characterised by slow erosion in recent years.

The problems of small and medium-sized enterprise financing are similar in the developed European countries and in Hungary, but in the former, enterprises have much easier access to external resources through the financial system. To date, 20-22% of Hungarian enterprises are bankable, whereas in the developed economies the corresponding rate is 70–85% [87].

The Micro Credit Programme has been available to micro-entrepreneurs since 1992. Initially, the credit amount was maximised at HUF 1 million (EUR 4 thousand). The programme criteria were modified several times. In 2000, the maximum amount was raised to HUF 3 million (EUR 12 thousand) and then, in the spring of 2002, to HUF 6 million (EUR 24 thousand).

The general aim of the Micro Credit Programme was to assist small businesses by financial support and consultancy, mainly in those special areas where the commercial banks were unable to satisfy their needs. Another objective was to make them an easier access to other development funds as soon as possible. From 1998 to 2005, more than 14 600 entrepreneurs were granted micro credit of a total amount of HUF 31 billion (EUR 123.3 million).

Table 9: Results of Micro Credit Programme 1998-2005.

Year	Number of enterprises	Credit provided (EUR million)
1998	1 734	6,9
1999	1 523	6,4
2000	1 928	11,5
2001	2 731	26,2
2002	4 145	37,4
2003	900	13,6
2004	646	5,6
2005	1 053	15,7
Total	14 660	123,3

Source: [87].

The early policies did not achieve their goals efficiently enough. There were hardly any built-in control mechanisms in the programmes to ensure effective implementation, and hence information required for impact assessment was insufficient. This resulted in the followings:

- Enterprise development policy failed to contribute sufficiently to establish markets of financial and business promotion services capable of autonomous operation. The fact that such market segments have only developed spontaneously is not a problem in itself, but with adequate help and backing, the process could have been accelerated in many areas.
- Only a small percentage of enterprises received assistance from the enterprise promotion system.
- Highly limited access prevented the majority of enterprise development instruments from meeting the criterion to make their impact felt without distorting competition.
- Part of the enterprise development intermediary organisations developed a "rent-seeking" type of attitude with little interest in the actual results and efforts targeted mainly at securing funding sources.
- The requirement of strong administrative control implied high administrative burdens in resources allocation. For economy of scale considerations, the support amounts were relatively high and that made very hard the access to these financial sources for the smallest enterprises.

- As the programmes were often discontinued after a single intervention, their impact was not permanent. Once access to extra funds had been terminated or reduced, the development instruments continued operating at a much lower level than before.

Business enterprises, co-operatives, individual entrepreneurs, and Hungarian branches or affiliates of foreign-registered corporations can legally conduct business in Hungary. At the end of 2004 the most common form of active joint enterprise was the limited partnership (44.5%), followed by limited liability companies (44.1%), while public limited companies represented only one per cent of registered commercial entities. Among active commercial enterprises, 95.5 per cent were classified as micro-enterprises (those employing less than 10 persons), while small enterprises represented 3.5 per cent, medium-sized entities 0.9 per cent, and large enterprises only 0.1 per cent [81].

Business can presently be established in five different forms:

- unlimited partnership (kkt),
- limited partnership (bt),
- joint enterprise (kv),
- limited liability company (kft), and
- public limited company (rt).

A business is legally established on the date the company is registered at the competent court of registry, after signing the deed of foundation and obtaining all necessary licences from the authorities. Companies also receive their tax number and statistical number at this time.

The total number of registered enterprises increased without interruption in the last three years, to close to 1.2 million. In 2004, there were 1 198 thousand registered enterprises in the economy, including 60% sole proprietorship and 40% corporate enterprises. The overall development conceals a slow decline in the number of sole proprietorship over the same period. Within the category of corporate enterprises, on the other hand, the share of unincorporated entities grows faster. The number of incorporated and unincorporated corporate enterprises is by and large identical, the first being predominated by limited liability companies and the second by limited partnerships. The share of general partnerships, companies limited by share and cooperatives, respectively, is but a fraction of these.

Table 10: Number of registered enterprises by legal form, 2000-2004.

Period	SP	GP	LP	LLC	CLS	Co-op	Total
2000	682 925	7 873	188 136	167 033	4 372	7 516	1 094 446
2001	698 001	8 213	199 152	172 919	4 423	7 074	1 124 835
2002	708 513	8 113	208 454	182 242	4 425	6 768	1 152 221
2003	716 729	7 889	214 787	193 247	4 345	6 790	1 176 934
2004	717 323	7 725	219 023	209 720	4 357	6 532	1 198 628

Source: [88]

Not all registered SMEs are active in their everyday business activities. The following Table 11 shows rate of active to registered enterprises, by legal form.

Table 11: Rate of active to registered SMEs by legal form, 2000-2004 (in %).

SME legal form	2000	2001	2002	2003	2004
Sole proprietorship	71	67	67	66	64
General partnership	90	88	87	88	84
Limited partnership	89	88	87	88	85
Limited liability company	87	87	87	89	87
Company limited by shares	87	89	87	89	87
Co-operative	79	81	80	82	80
Average	77	75	75	75	73

Source: [88].

All things considered, the proportion of active enterprises showed a declining trend from 2000 to 2004. The value of this indicator was stable for incorporated enterprises and declined for unincorporated entities. The share of inactive enterprises is the highest among sole proprietors.

Most enterprises operate in the complex branch including real estate trade/renting, IT and business, and business support services. This is followed by commercial enterprises and then by manufacture and construction. These were the largest enterprise groups, including, altogether, more than three-fourth of all enterprises in 2003. The relative weight of agriculture, transport, catering and the other services branches is smaller.

The following Table 12 presents the branch distribution of active enterprises.

Table 12: Branch distribution of active SMEs in 2000 and in 2004 (in %).

	2000	**2004**
Agriculture	3.5	4.5
Manufacture	12.1	8.8
Construction	8.2	9.4
Trade	27.6	21.1
Catering	3.9	4.6
Transport	3.5	4.8
Financial services	0.9	3.1
Real estate, renting and business activities	31.3	31.0
Education	1.5	3.0
Health care	3.1	2.8
Other services	4.3	6.9
Total	100.0	100.0

Source: [88].

The Table 12 clearly shows the development trends of the branch distribution of enterprises. The share of commercial enterprises diminishes at a fast pace. That of industrial ones tends to decline and that of construction entities to rise. In 2004, the proportion of construction enterprises already exceeded that of industrial ones. Furthermore, there is an obvious increase in the relative proportion of services branches.

The overwhelming majority – 96% – of Hungarian enterprises are micro-enterprises. Small enterprises included, their share exceeds 99%. As for corporate enterprises, on an average, incorporated companies are of a larger size than unincorporated ones.

Table 13: Distribution of active enterprises by legal form and staff category, 2004 (in %).

	0 employee	1 – 9 employees	10 – 49 employees	50 – 249 employees	250 + employees	Total
SP	17.5	82.0	0.5	0.0	0.0	100.0
GP	28.3	68.6	3.0	0.1	0.0	100.0
LP	35.5	62.9	1.6	0.1	0.0	100.0
LLC	27.9	58.7	11.3	1.9	0.3	100.0
CLS	13.3	25.5	25.2	24.4	11.5	100.0
Co-op.	50.0	28.0	15.4	6.4	0.2	100.0
Total	26.3	69.8	3.2	0.6	0.1	100.0

Source: [88].

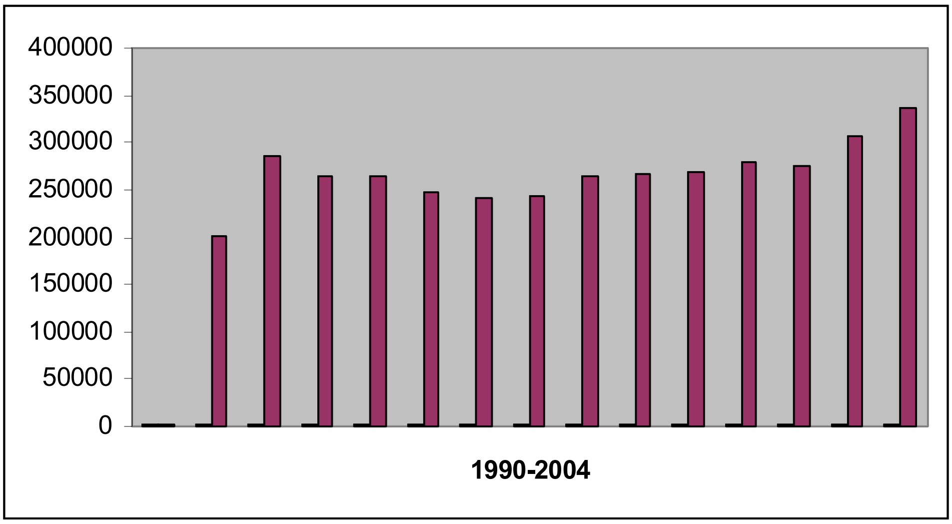
2.4.6 Commercial enterprises in Slovakia

The existence of stimulating business environment represents the basis for successful development of the small and medium enterprise sector. Improvement of the business environment in recent years has gradually projected into quantitative characteristics of the SME sector. An in-depth analysis of the SME sector status allows to identify prevailing trends and to timely respond to changes needed to secure a desirable situation. This subchapter presents the quantitative characteristics of the SME sector in Slovakia in the context of its development in the few recent years, the main findings of the surveys conducted among small and medium enterprises, and a comparison of the available data about the business sector in Slovakia and the EU.[10]

Resulting from the data of the Statistical Office of the Slovak Republic, the following Charts 6 and 7 provide the information about the development of numbers of natural persons. The number of total natural persons in 2004 was 360 378, thereof 336 640 were small trade licences, 13 683 persons doing business in free occupations and 10 055 independent farmers. Most of small trade licences were doing business in trade (115 215).

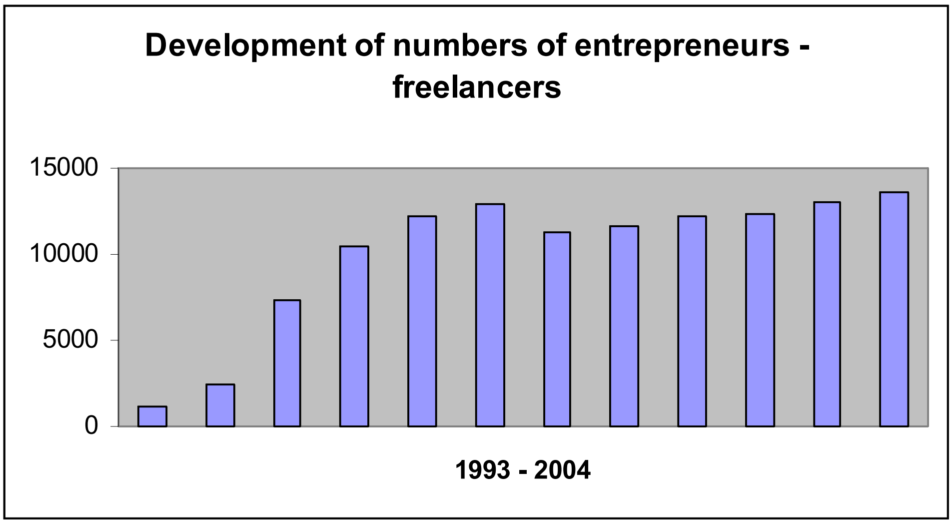
[10] The evaluation of the status of the SME sector presented in this subchapter is based on data from the statistical register of organisations and the data published by the Statistical Office of the Slovak Republic. Data for EU Member States were derived from the publication SMEs in Europe – Economic report Observatory of European SMEs.

Chart 6: Development of natural persons in 1990-2004.



Source: [80].

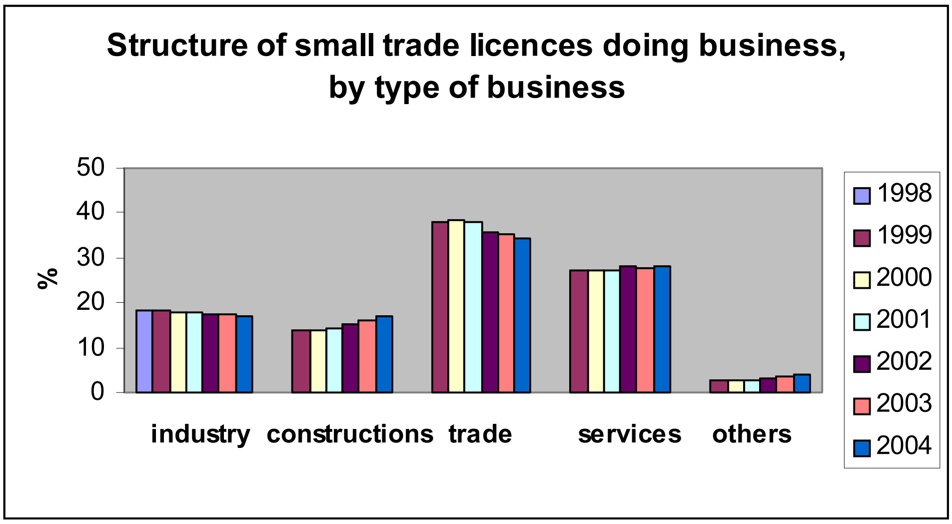
Chart 7: Development of numbers of entrepreneurs - freelancers in 1993-2004.



Source: [80].

In 2004, a total of 56 716 persons started up business and 18 812 persons ceased to involve in business. The biggest changes concerned the sector trade, real estate and retail business, manufacturing of goods, and building industry. The structure of small trade licences by sectors remains relatively stable (Chart 8).

Chart 8: Structure of small trade licences by sectors.



Source: [67].

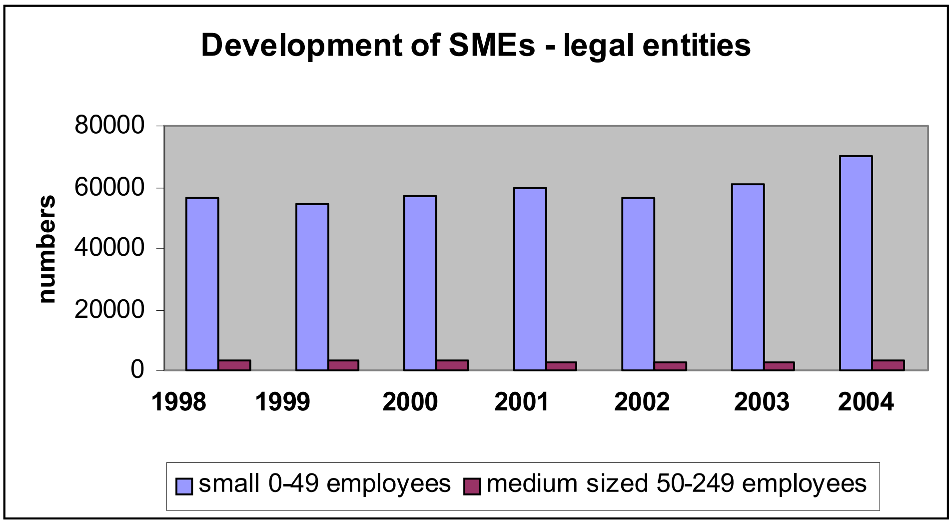
Within 2000 and 2004, a trend of a significant reduction of the share of small trade licences doing business in trade is visible (by 4,2 p.p.), with a slight reduction of the shares of small trade licences doing business in industry (by 1,1 p.p.) and a marked increase of the numbers of small trade licences doing business in constructions (by 3,2 p.p.). Compared to 2000, the numbers of small trade licences increased.

There were 114 285 legal entities registered with the register of organisations of the Statistical Office of the Slovak Republic at the end of 2004, thereof 74 207 companies and 40 078 non-profit organisations. Year-on-year, the total numbers of legal entities increased by 12,7%.

Small enterprises accounted for the key portion of the total numbers of profit making organisations (94,9%, including micro-enterprises with 0-9 employees – 80,5%). Medium sized and large enterprises accounted for 4,2 % and 0,9%, respectively. The numbers of small enterprises increased by 9 316, those of medium and large enterprises by 401 and 70.

There were 70 418 small private enterprises with up to 49 employees, 3 136 medium sized enterprises with between 50 and 249 employees. The development of the numbers of SMEs is illustrated in Chart 9.

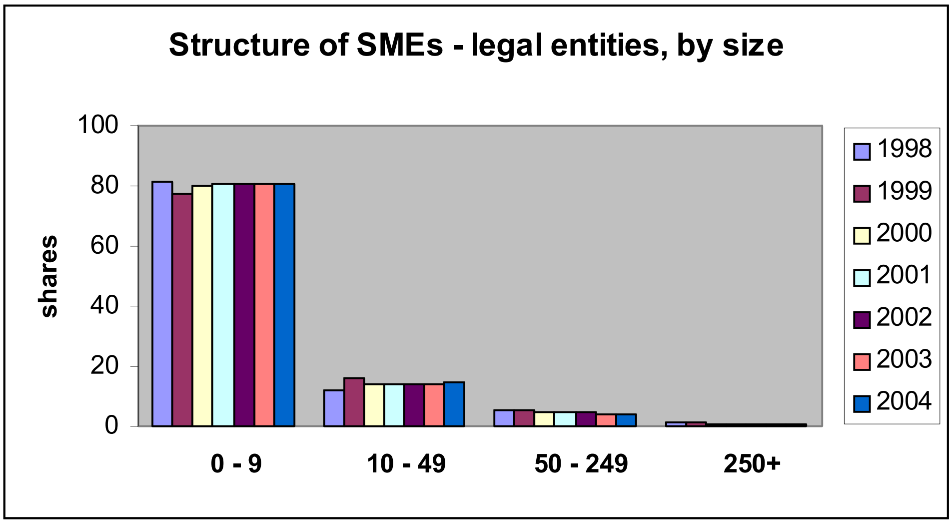
Chart 9: Development of SMEs – legal entities.



Source: [67].

There was a reduction of the share of micro enterprises observable in the last year by 0,2 percentage point, and an increase in the share of small enterprises by 0,2 p.p., with the share of medium and large enterprises remaining unchanged.

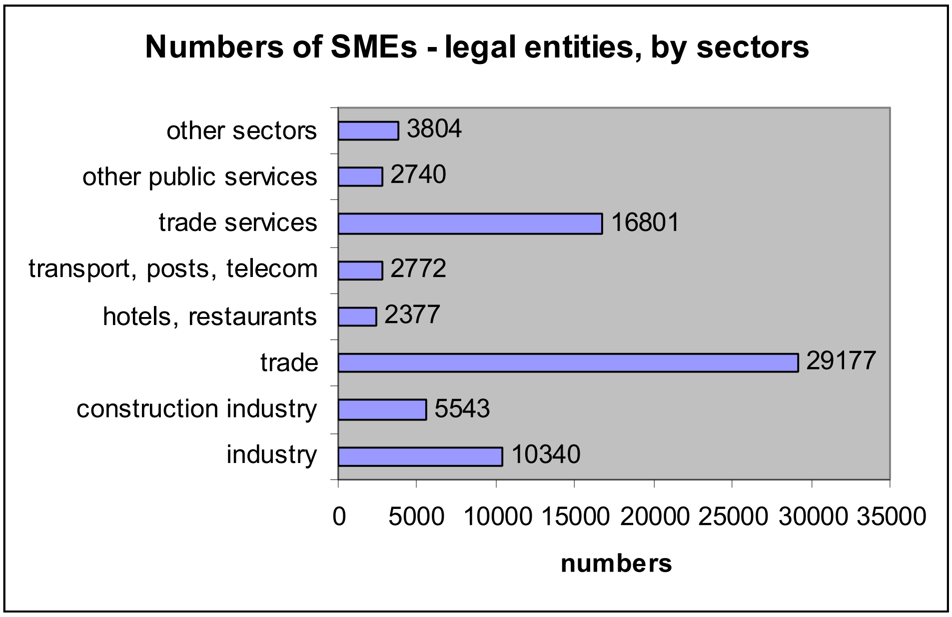
Chart 10: Structure of SMEs – legal entities, by size.



Source: [67].

The structure by sectors is shown in Chart 11. Most of SMEs were operating in the sectors of trade, commercial services and financial sector, industry and building industry.

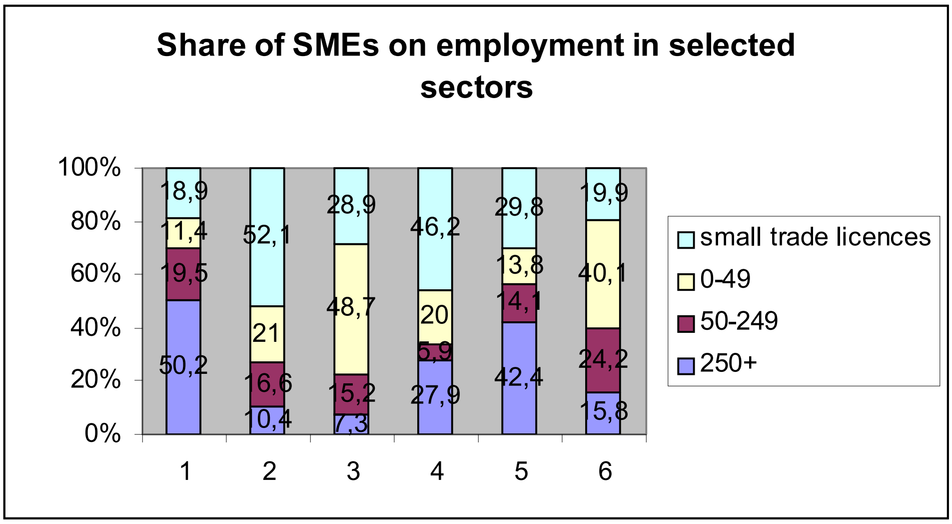
Chart 11: Numbers of SMEs – legal entities, by sectors.



Source: [67].

The contributions of SMEs to employment in the different sectors is shown in the following Chart 12. For the category of small trade licences, 610 thousand people were estimated, with the figures for small, medium and large enterprises being 412,4 thousand; 388 thousand; and 619,5 thousand, respectively.

Chart 12: Share of SMEs on employment in selected sectors.



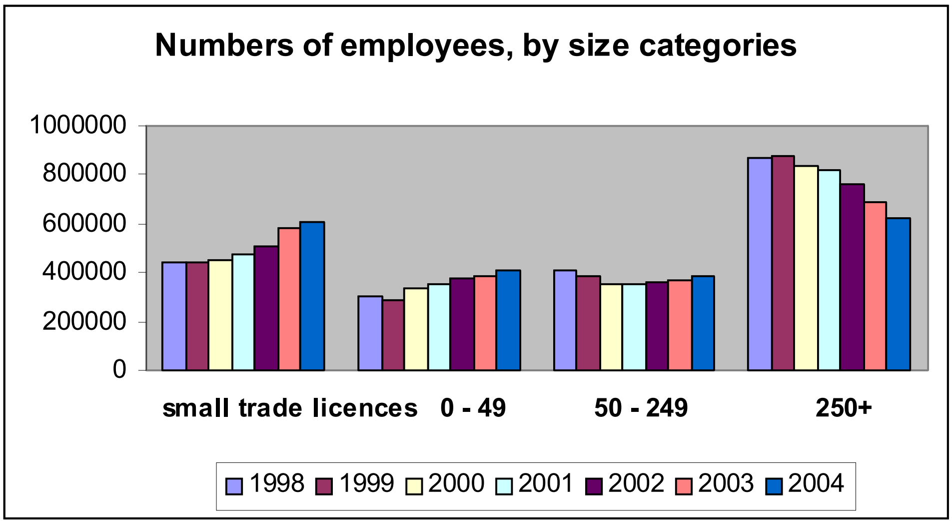
Source: [67].

Legend:

1 – industry, 2 –building industry, 3- trade, 4 – retail, 5- transport, 6 – market services.

Employment by size category of the enterprises and its development within the recent 7 years are illustrated in Chart 13.

Chart 13: Numbers of employees, by size categories.

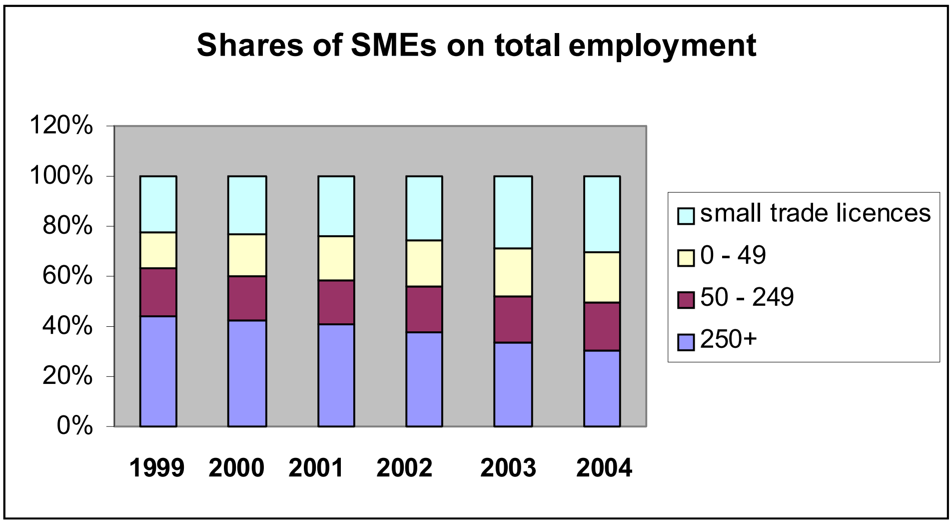


Source: [67].

Employment increased in the category of SMEs including small trade licences by 5,6%. For large companies, a drop by 10,1% was recorded, due to the ongoing restructuring and making activities in large enterprises more efficient after the completion of the privatisation process during the proceeding years.

The role played by SMEs in respect of employment is evident from Chart 14. SMEs provided employment to 59,4% of the earning population in 1997, with an increase up to 69,5% in 2004.

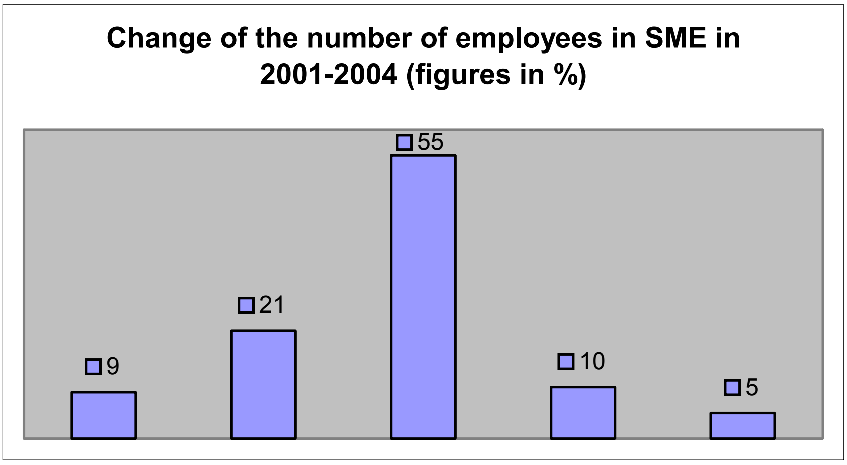
Chart 14: Shares of SMEs on total employment.



Source: [67].

How did the number of employees change during the period 2001-2004? More than half of SME declared no change in the number of employees, more than one fifth declared an increase by more than 10% and tenth of SME that the number of employees decreased by more than 10%.

Chart 15: Change of the number of employees in SME in 2001-2004 (in %).



Source: [66].

<u>Legend:</u>

9% - it increased by more than 30%,

21% - it increased by more than 10%,

55% - it remained equal,

10% - it decreased by more than 10%,

5% - it decreased by more than 30%.

The category of SMEs where the number of employees remained equal is mostly represented by SMEs with turnover up to 1 mil. Sk (73%), with number of employees 0 to 9 (60%) and with seat in Nitra (60%), Trenčín and Banská Bystrica regions (both 61%).

Enterprises that increased the number of employees by more than 10% had turnover from 5 mil. to 10 mil. Sk (39%) and from 50 mil. to 100 mil. Sk (34%), they were employing 10 to 49 workers (29%) and 50 to 249 workers (27%), they provided the business activities in the area of financial services (38%) and they had a seat in Žilina (28%) and Prešov regions (37%).

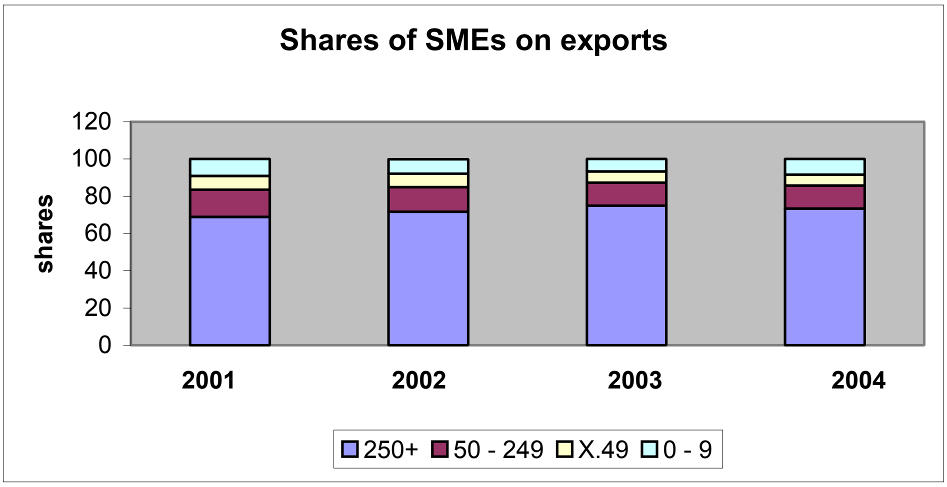
Representatives of SMEs who declared decreasing of number of employees by more than 10% had turnover from 50 mil. Sk to 100 mil. Sk (18%) and over 100 mil. Sk (21%), number of employees from 10 to 49 (17%) and from 50 to 249 (23%), performing in the industrial production (15%), agriculture (17%) and transport, post and telecommunications (24%).

The analysis of foreign trade and export activities of SMEs is also a key indicator and one of the important characteristics of SMEs. The volumes of exports increased 11,4% in 2004 compared to 2003. In respect of the major economic groupings, exports grew into the EU Member States by 12,2% as well as to OECD countries by 10,9%. As for the destination, larger exports concerned mainly the Czech Republic (by 15,1%), Poland (by 28%), Austria (by 17,6%), the United Kingdom (by 51,9%), Hungary (by 18,9%), and the Netherlands (by 26%). Fewer goods were exported to mainly Italy (by 5,1%), China (by 51,1%), and Switzerland (by 16,7%).

As Chart 16 illustrates, the share of micro-enterprises (0 – 9) on the overall export in 2004 was 8,3% (72,6bn Sk), small enterprises (10 – 49) share was 5,9% (51,3bn Sk) and medium enterprises (50 – 249) share reached 12,4% (107,8bn Sk). The biggest share of total export 73,4% was from large enterprises (almost 638bn Sk).

Development of export between 2001 and 2004 according to size of the enterprises illustrates Chart 16. The most dynamic growth of export, even up to 35% (18,8bn Sk) in comparison with 2003 was registered in micro-enterprises. Increase in export of small enterprises was 7,8% (3,7bn Sk) and of medium enterprises 8,6% (8,5bn Sk). The lowest increase of export 6% was recorded in large enterprises (35,9bn Sk).

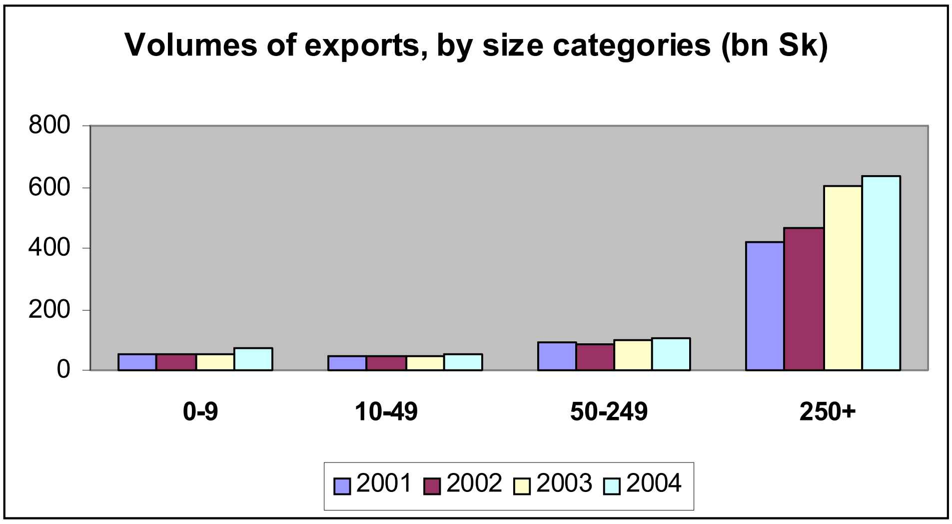
Chart 16: Shares of SMEs on exports.



Source: [66].

The share of SMEs on overall export is strongly influenced by the exporting performance of large enterprises, and therefore in the upcoming years it is reasonable to expect a slight decrease in the SME's share on the total volume of exports.

Chart 17: Volumes of export, by size categories (bn Sk).

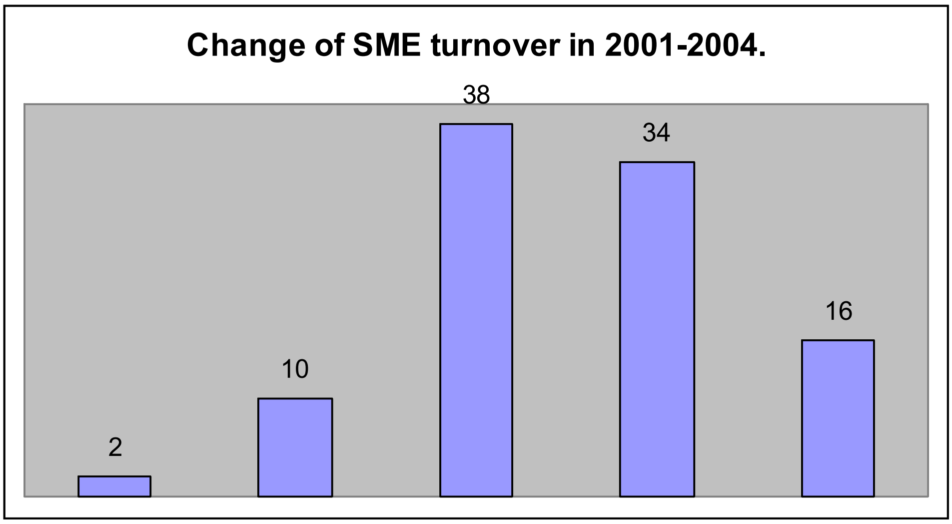


Source: [66].

Change of year's turnover is a significant factor in the economic activities of SME. Concerning period 2001 – 2004, almost two fifths of responders replied that their turnover grew up by more than 20 % and more than one third of SME representatives said that they did not notice any turnover change. Slight share of two per cent of SME argued that their turnover grew up over 100%.

SME employing 10 to 49 workers (44%), 50 to 249 workers (52%) as well as those performing in the industrial production (49%), constructions (43%), transport, post and telecommunications (47%), financial services (46%) and seated in Bratislava (44%), Žilina (51%) and Prešov (56%) regions were the ones which turnover grew up by 20% and more.

Chart 18: Change of SME turnover in 2001-2004.



Source: [66].

Legend:

2% - it increased by more than 100%,

10% - it increased by more than 50%,

38% - it increased by more than 20%,

34% - it remained unchanged,

16% - it decreased.

Enterprises providing the entrepreneurial activities in hotel and restaurant services (39%) and in "other" activities (50%) and with seat in Trnava (41%), Nitra (44%) and Banská Bystrica (43%) regions did not notice any change in turnover.

Every tenth of asked SME representative said that their turnover increased by more than 50%. This fact concerns mainly the enterprises providing the financial services (54%) and seated in Bratislava and Košice regions (both 15%).

Table 14: Change of SME turnover in 2001-2004.

Number of employees / Answers	**01**	**02**	**03**	**04**	**05**
0 - 9	1	9	37	35	18
10 – 49	6	10	44	30	10
50 – 249	2	14	52	25	7
Activity					
industrial production	2	13	49	27	9
agriculture	4	13	37	21	25
trade	1	6	37	21	25
hotels, restaurants	0	14	23	39	24
construction industry	5	11	43	32	9
transport, post, telecommunication	0	9	47	26	18
financial services	0	54	46	0	0
trading services	2	11	39	33	15
other	5	3	27	50	15
Region					
Bratislava	1	15	44	26	14
Trnava	1	8	31	41	19
Trenčín	7	6	30	38	19
Nitra	2	9	30	44	15
Žilina	0	6	51	31	12
Banská Bystrica	2	3	35	43	17
Prešov	0	9	56	18	17
Košice	1	15	38	30	16
Slovak average	2	10	38	34	16

Source: [66].

Legend:

01 – it increased by more than 100%,

02 – it increased by more than 50%,

03 – it increased by more than 20%,

04 – it remained unchanged,

05 – it decreased.

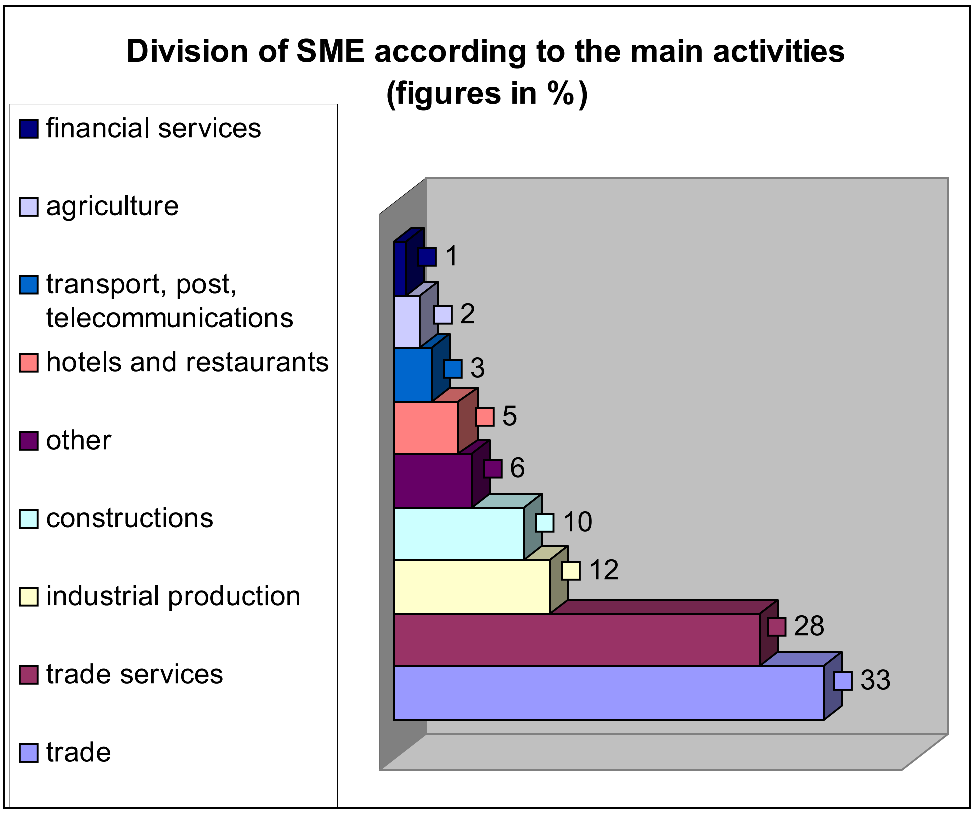
The final division and characteristic of the Slovak SMEs is their division according to the main activity. Almost one third is orientated on trade, more than a quarter on trade services, more than tenth on industrial production and tenth of SMEs on constructions.

SMEs dealing with the industrial production had turnover mostly from 1 mil. to 5 mil. Sk (41%) and they had a seat in Žilina (50%) and Prešov (43%) regions.

The most of SMEs orientated on trade services were amongst the ones with turnover 5 to 10 mil. Sk (33%) and situated in Bratislava (36%), Nitra (35%) and Košice (33%) regions.

SMEs focusing on industrial production had mostly turnover from 5 to 10 mil. Sk (17%), from 10 mil. to 50 mil. Sk (19%), from 50 to 100 mil. Sk (30 %) and over 100 mil. Sk (21%). The majority of SMEs had 10 to 49 employees (26%) and 50 to 249 employees (41%), with a seat in Trenčín region (21%).

Chart 19: Division of SME according to the main activities (figures in %).



Source: [66].

SMEs providing the entrepreneurial activities in constructions had turnover from 50 mil. to 100 mil. Sk (16%) and over 100 mil. Sk (42%), number of employees 10 to 49 (48%) and the seat in Trnava region (18%).

Table 15: Division and placement of SME in Slovakia (figures in %).

Answers **Number of employees**	**01**	**02**	**03**	**04**	**05**	**06**	**07**	**08**	**09**
0 - 9	7	2	37	5	8	3	1	31	6
10 – 49	26	2	22	7	18	3	1	15	6
50 – 249	41	11	14	0	14	4	0	14	2
Region									
Bratislava	9	1	35	6	6	3	4	36	0
Trnava	10	8	31	2	18	3	0	15	13
Trenčín	21	4	23	4	13	4	1	22	8
Nitra	10	1	23	8	10	3	1	35	9
Žilina	13	2	50	1	8	3	0	18	5
Banská Bystrica	8	2	36	1	10	3	1	30	9
Prešov	12	2	43	8	9	4	1	16	5
Košice	9	1	35	6	10	1	0	33	5
Slovak average	12	2	33	5	10	3	1	28	6

Source: [66].

Legend:

01 – industrial production,

02 – agriculture,

03 – trade,

04 – hotels and restaurants,

05 – constructions,

06 – transport, post and telecommunications,

07 – financial services, insurance,

08 – trade services,

09 – other.

The second hypothesis supposed that SME sector is one of the main influencing elements of the economic stabilization and growth. The growth of the economy is measured and in dissertation expressed by GDP per capita, and latter also by rate of inflation, growing employment, or decreasing level of unemployment. As seen from presented facts and figures in several charts and tables from both Hungary and Slovakia, we can conclude that SMEs maintain a strong and significant entrepreneurial sector and that these enterprises have vast and vital impacts on whole employment and increasing living standard of citizens.

Thesis 2: I confirm the second hypothesis that SMEs did contribute to the growth of both economies during the analysed periods and they are expected to maintain their position within the economic significance. My statements are: Real GDP grew in both

countries, although its growth in Slovakia was much stronger (6-9% per year) than in Hungary (3-5% per year). Technology transfer together with direct investments in SMEs contributed to the growth of the labour productivity which was bigger in Hungary than in Slovakia (60-70% comparing to 55-65% per person employed of the EU-25). As supposed in hypothesis 2, the SMEs with their positive performance (increased revenues, growing number of SMEs, growing employment in SME sector) contributed also to price stability, since the inflation rate decreased in Slovakia from 13-15% in 1994 and 1995 to 6-7% in 1999 and 2-3% in 2006, and in Hungary from 18-22% in 1992-1996 to 10% in 1999 and 2-5% by 2006 respectively. Significant is also an impact of SMEs on employment growth. The number of SMEs both enterprises of all legal forms as well as natural persons increased (in Hungary up to 1.2 million in Slovakia up to 500 thousand by 2006 respectively) and thus they increased the employment rate. The highest share on employment have services, the lowest agricultural production. The share on employment of natural persons has grown up to 30%, medium enterprises 20%, small enterprises 14%, micro enterprises 7%, the rest belongs to big enterprises. Share of SMEs on gross production and total export was with increased volumes since 2003 what also increased GDP.

3 FINANCIAL SOURCES OF SMEs

Providing the entrepreneurial activities is connected with financing - obtaining the financial means and investing – use of financial means. Entrepreneurship in the market economy is based on usage of money relations. The entrepreneur enters into many and various financial relations such as realisation relations, credit, insurance, budgetary and other relations that increase a pressure on firm management.

Access to finance is one of the main issues for an entrepreneur, whether located in Slovakia, Hungary or another EU country.

The main tasks of firm management are:

- to obtain the financial means and capital required for financing of current and extra enterprise needs,
- to allocate capital,
- to divide profit,
- to reach equilibrium – enterprise liquidity.

One of the most important tasks of financial firm management is to determine required financial means and to obtain the most effective sources as possible.

The long-term successful performance of SMEs on joint EU market requires constant product and technology innovation. Investments to innovation require a lot of capital what forces the entrepreneurs to seek for brand new forms of financing. One of the possibilities is to increase basic capital and thus to obtain sources for a long-term development without any duties to repay loan and interest. On the other hand, such increasing of basic capital may cause a duty to share decisions with another accompanier.

It is clear that small and medium enterprises do not dispose with required guarantees and deserved credit history. Since it is very difficult for SMEs to obtain bank loan, they need own sources, non-traditional financial sources and state aid.

3.1 Division of financial sources of SMEs

In fact, we can divide sources of financing according to the circumstances of financing, period of financing, ownership relations and way of obtaining sources [20].

3.1.1 Financing according to the circumstances

Financing according to the circumstances shows when and how circumstance that requires capital occurs and how many occasions and activities need to be financed at one moment.

Current financing is a constant financing in existing business. This way of financing is related to floating assets. Current financing can be divided into:

- Financing of operations: it provides financing of common activities in the enterprise. These activities include purchase of material, fuel, energy, wages, payment of transport, payment of taxes and insurance. It is important to provide floating capital in accurate volume and right time.
- Financing of investments: it means usage of finances for the recovery and development of business. Usually, enterprises need the financial sources in certain volume and structure what could be a disadvantage of SMEs. It is important to have fixed capital.

Extra financing is realised in exceptional, extra situations. It concerns financing of enterprise establishment, merging of enterprises or liquidation of enterprises.

Launching entrepreneur requires financial sources in order to pay licences, confirmations, purchase or lease building, new technologies, equipment, machines, inventories, wages, etc.

3.1.2 Financing according to the duration of obtained capital

Small and medium enterprises obtain financial capital mostly from borrowed sources. Obtained capital is either short-term, middle-term, or long-term.

Short-term financing focuses on sources used not longer than one year. These sources are obtained by supplier's loans or overdraft loans. Except of these forms of financing, the entrepreneurs can use bank loans or deposit of owner or partner.

Middle-term financing is the most frequent used method. It focuses on middle-term loans with 3 to 5 years of maturity. SMEs have a difficult access to these loans and for launching entrepreneurs they are almost unreachable. That is why several supporting programmes were worked out for launching entrepreneurs.

Long-term financing is provided mainly by bank loans with the maturity of 5 and more years. Such loans are offered to big enterprises and in minimum volume. SMEs can hardly obtain them and therefore they use different methods of long-term financing such subsidies, leasing, venture or developing capital.

3.1.3 Financing according to the ownership relations and way of obtaining the sources

Development of entrepreneurship is based on sufficient disposable sources that are directed towards this area and are used for the investments.

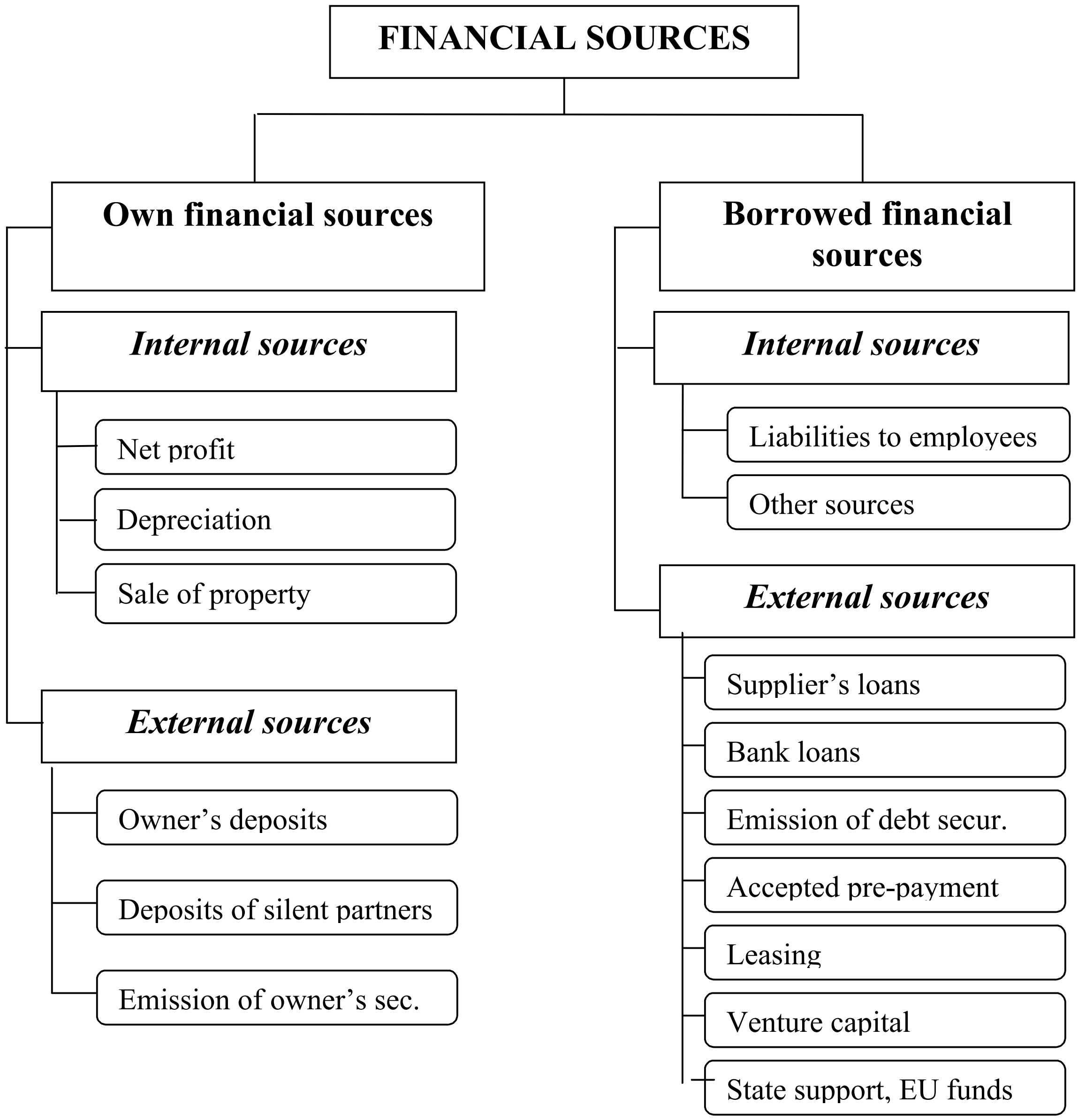
In transition economies, such Slovak or Hungarian, as the main problem occurs the lack of own capital when business is launched. Sources of business financing can be classified according to the ownership relations as follows:

- own sources, to which belong capital given to entrepreneurs as well as those in a form of property invested in a business, depreciation of investment property, retained earnings, etc.
- borrowed capital that can be obtained from other subjects. They are of different forms, depending on sources and conditions of obtaining. The most often used is a bank loan.

It is important to distinguish own and borrowed financial sources. An optimal financial structure of enterprise is considered to be the one when costs for obtaining the capital are minimal and capital is compatible with the enterprise property structure.

It is generally approved that only long-term assets that are vital for the enterprises should be financed from own capital. The other long-term assets can be financed from long-term foreign sources. When long-term own sources are used for financing of floating assets, the enterprise is overcapitalised what decreases its efficiency. On the other hand, when the short-term borrowed sources are used to finance long-term enterprise assets, the enterprise is undercapitalised.

Figure 3: Division of financial sources.



Source: Own elaboration.

3.2 Own financial sources

Figure 3 shows that we can divide both own and borrowed financial sources on internal and external sources of financing which include wide scale of opportunities for the enterprise financing.

3.2.1 Own internal financial sources

3.2.1.1 Profit

Profit in enterprise as a financial category of business sphere ought to be explored so that enterprise can determine the influence of this category on creation, distribution, and use of funds. Profit is an important for creation the funds that can be used for production start-up and for financing of growing requirements of its development, for financing of accumulated fixed and floating assets.

Profit is the most important internal financial source for SMEs. Since the income tax is paid, enterprise obtains a disposable profit that can be used for the enterprise financing. Another element in profit distribution is creation of obligatory reserve funds that are determined in Commercial Code.

Decision about how to distribute profit in enterprise of single person is provided by entrepreneur himself. Generally, part of profit is used for the enterprise development and part for the coverage of personal expenditures. In business corporations, profit must be used according to the corporation contract or articles of incorporation. The nature is what part of profit would belong to owners and what part would be left for the enterprise financing.

The advantage of financing from profit is that it increases own capital base - own assets. Enterprise thus decreases a need for foreign financial sources. The independence of entrepreneurial subject is another advantage and high coverage by own capital simplifies obtaining new foreign sources.

Use of profit remaining in enterprise depends mostly on opportunities for realisation of enterprise development conception, from the opportunities for realisation of up-to-date technology progress. Since the enterprise is profitable, it does not require many loans which are usually very expensive and unreachable for SMEs.

3.2.1.2 Depreciations

Depreciations mean financial expression of physical and moral deterioration of fixed assets for given period and at once they are main and stable source of financing of their reproduction. They are in use as long as another property replaces depreciated one. The problematic of depreciations is connected with using of immovable assets, moveable assets, financial property, unused inventories as well as claims abandoned.

From presented facts we can find out that the enterprise can actively affect not only their level but also the level of fixed assets, realisation of technological progress, or change in production programme if it uses depreciation correctly.

Depreciations are included into expenditures at the end of the year when the entrepreneur practices single-entry accounting and tax base consists of revenues decreased by approved expenditures.

Enterprises practising double-entry accounting include depreciations into costs. They decrease revenues before profit and thus lower a tax base. Depreciations turn up into costs constantly and they are not used for modernisation and property renewal immediately. It is replaced and modernised after its life cycle expiration.

For corporation tax purposes tax depreciation adjustment is done as follows:

- The following assets may be amortized for tax purposes in accordance with the method used in the financial statement: intangibles, utilities of industrial parks, assets used for basic research, applied research or experimental development, appliances not exceeding HUF 200,000 (EUR 800) in value, assets which may be amortized for tax purpose at a rate of 33%.
- Buildings depending upon their construction: 2%, 3% or 6%. Machinery, equipment: 14.5% or 33%.
- Computers, film- and video making equipment, as well as appliances installed after January 1, 2005 may be amortized within two years.
- Vehicles: 20%.
- Land is not subject to amortization.
- Fixed assets rented or hire out: buildings 5%, other assets 30%.

Table 16: Depreciation rates in Slovakia.

Depreciation group	**Depreciation period**
1	4
2	6
3	12
4	20

Source: [78].

Companies can choose either balanced or fasten way of depreciating.

3.2.1.3 Sale of property

Sale of property also belongs to internal own sources of financing. It is one of the forms of enterprise self-financing. Entrepreneurs use this form of financing in case of shortage of funds, if they are willing to change production structure or subject of business. They decide to sell such property that loads their financial situation the most. Since such property is sold, they obtain necessary financial sources in order to sustain a constant growth.

3.2.2 Own external financial sources

External sources are significant in establishing new enterprises and in their further development. They are determined by legal form of corporations. The enterprise can increase financial sources by increasing owner's deposit, by taking on other partners or transformation to another company.

3.2.2.1 Owner's or partner's deposits

Owner's or partner's deposits are provided when enterprise is established and when basic capital is increased. These deposits are both of financial and non-financial character. Financial sources are usually used to finance new or existing enterprise activity. Non-financial deposits indirectly influence the need of financial sources because deposit in a form of movable and immovable property lowers the need of financial sources that would be necessary for their purchase.

In case of single-person enterprise, the range of basic capital as well as its increasing depends on financial situation of owner or individual entrepreneur. The level of minimum basic capital is not strictly set; it depends only on financial situation of entrepreneur. This form of business is characteristic for tradesmen. If they have few financial sources they can get a silent partner who deposits capital to enterprise on a basis of contract but he does not participates on enterprise management.

In case of corporations or collectives, they are characterised by joining the capital of certain number of partners in order to reach stated goals. Participation of partners is not based on financing but partners can share management and they cooperate between each other.

3.2.2.2 Deposit of silent partner

Deposit of silent partner is a deposit of person entering an enterprise by his deposit on a basis of contract about silent partnership. Silent company is thus established but it is not written down in Commercial Code.

Silent partner offers to entrepreneur certain deposit and contributes on business and entrepreneur must repay him a profit resulting from his share. Such investments of silent partners occur when they have enough financial sources and know-how.

This way of financing is often based on trust and good personal relationships between entrepreneur and silent partner that ventures certain risk.

3.3 Borrowed financial sources

3.3.1 Borrowed internal financial sources

Borrowed internal sources mean commitments of entrepreneur to employees in a form of unpaid wages, salaries, and bonuses, to partners from their deposits and further sources that contribute to financing of enterprise activities.

Commitments to employees arise when enterprise does not have enough financial sources to pay them. Labour force produces outputs that bring revenues to enterprise.

3.3.2 Borrowed external financial sources

Entrepreneur uses borrowed external financial sources because of lack of private capital and because of taxation point of view; interests are part of costs and thus they decrease tax base.

External financing sources accessible for small and medium-sized enterprises have expanded substantially over the past 4–5 years. Credits offered on market-terms by commercial banks played a leading role in the process. Between 1999 and 2004, the SME credit stock went up from HUF 460 billion (EUR 1.8 billion) to more than HUF 2000 billion (EUR 8 billion) representing five-fold growth. At the end of June 2005, SME credits represented more than half of the total corporate credit stock [89].

Although the guaranteed credit stock remained under 10%, state guarantees played an important part in fostering the relationship between commercial banks and small businesses.

The main engine of growth, however, was the introduction of the new cheaper credit assessment and debtor-rating procedures worked out by the commercial banks, while the number of creditworthy small business has increased as well. The supply of venture capital and other financial instruments has also shown an improving trend. The current development dynamism suggests that, in terms of financial intermediation to SMEs, the gap between more developed market economies and Slovakia and Hungary will become smaller in the coming years.

Bank financing of micro, small and medium-sized enterprises proved dynamic development. Credit stock increased in every size category of the sector much faster than for large companies, and its share in the total corporate credit stock has been expanding, too. Share of small and medium-sized enterprises in the stock of credits extended by banks to the total corporate sector was increasing steadily from 19.3% in 1999 to 48.2% at the end of 2004 and 55.6% at the end of June 2005 [87, 89].

3.3.2.1 Emission

Emission is a kind of loan offered by repurchasing the obligations or bills of exchange that debtor emits in order to obtain financial sources. The entrepreneurial sphere can thus obtain long-term or short-term loans by emitting the firm obligations, by borrowing from different investment funds in a form of obligations or by issuing the bills of exchange.

3.3.2.2 Commercial papers

Commercial papers are used to obtain loan by emitting and underwriting on money market. It is short-term debt security which is sold on money market to investor. Such security is emitted by especially well-known corporations in order to obtain short-term financial sources. SMEs use them only occasionally.

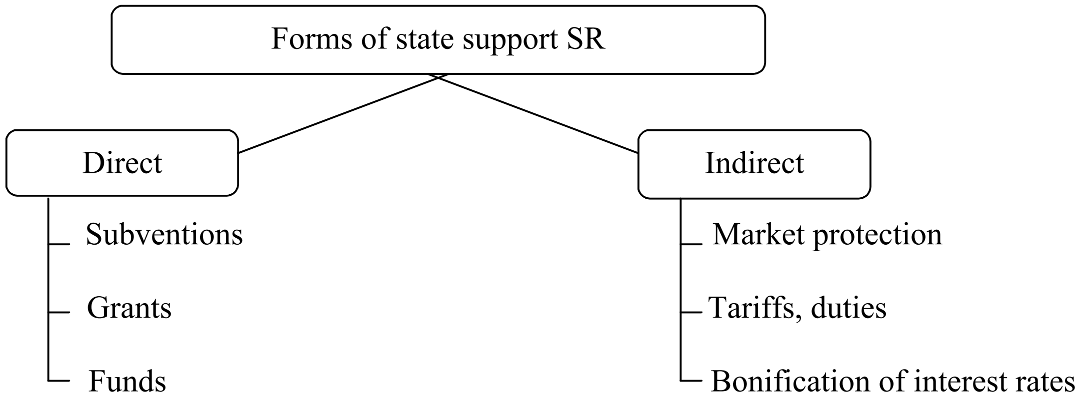
3.3.2.3 Advance payments

Advance payments are commonly used source of borrowed finances. Customer submits short-term financial payments to supplier before he starts working. Financial pre-payments are used to finance the production that has longer production cycle. In practice, they are often paid in small parts after certain production is made and before another one started. They should maintain capital return of entrepreneur.

3.3.2.4 State support

State support is another form of external SME financing. Entrepreneurs can be supported by state directly or indirectly (see Figure 4).

Figure 4: Forms of direct and indirect state support of SMEs.



Source: [68].

- **Direct financial support** involves tools for increasing the enterprise revenues. Support is submitted from assigned sources from state budget in a form of systemic and price subventions or in a form of quotas. State can support the enterprises financially by grants which are one of the forms of long-term financial sources. State offers specific subsidies (systematic) or non-specific subsidies (exceptional or global). State can also support the enterprises with financial contributions from the investment, share or development funds.
- **Indirect financial support** occurs in decreasing the expenditures of entrepreneurial subjects or in decreasing the financial risk. The concrete examples of indirect financial support are protection of the market by tariffs, duties, import additional charges, state guarantees, or tax allowances.

3.3.2.5 Supplier loan

Supplier loan is offered by supplier to customer to pay for delivery in agreed periods. This loan is offered on purchased goods or provided services. For suppliers, who thus become creditors, such loans are too expensive because they are often forced to lend money in order to make a production.

3.3.2.6 Bank loan

Bank loan is a contract between creditor offering the financial sources and debtor. Bank offers a bank loan to cover present needs and thus allows the enterprise to provide fluency of reproduction process.

The need of loan and its acceptable price results from the investment policy of enterprises, from production realisation, from seasonal character of production, from time differences between sources requirements for the entrepreneurial activities' development and their creation in the entrepreneurial sphere. The loan level and structure in the entrepreneurial sphere and their interest rates are different depending on every enterprise, branch and economic divisions.

Interest is defined as a price of borrowed capital. Subject with free capital placing on financial market receives lower price (lower interest) than the one needing financial capital to cover his needs and therefore he must pay higher price (higher interest). Interests obtained from deposits are revenues for the enterprises and paid interests from obtained loans are costs for the enterprises.

The level of interest rate depends on durability, requirements and loan supply on financial markets, from risk and coverage, interventions from central bank, ministry of finance and other financial institutions.

The interest rate also depends on discount rate of national (central bank) that offers the loans to commercial banks. Table 12 shows a discount rate of the National bank of Slovakia from 1993 till 2006. Since 1st January 2003 it is called "basic interest rate of NBS".

The level of interest rates influences decisions of entrepreneurs whether to use foreign financial sources. The following Charts 25 – 27 involve average interest rates in commercial banks for the SMEs and private sector in 2001 – 2005 in Slovakia. Decreasing of interest rates from Chart 25 is positive and thus the bank loans are more attractive and accessible for the entrepreneurs.

Chart 20: Interest rate of all used loans.

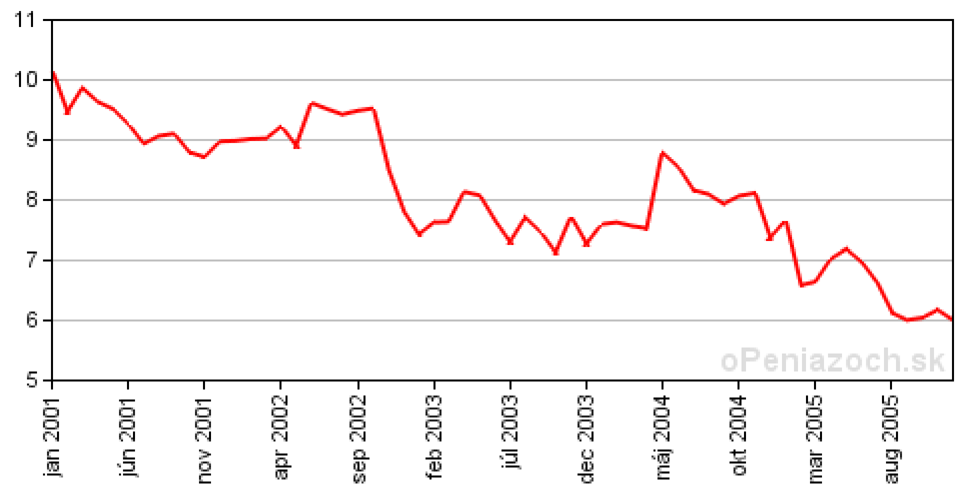


Chart 21: Interest rate of loans in the private sector.

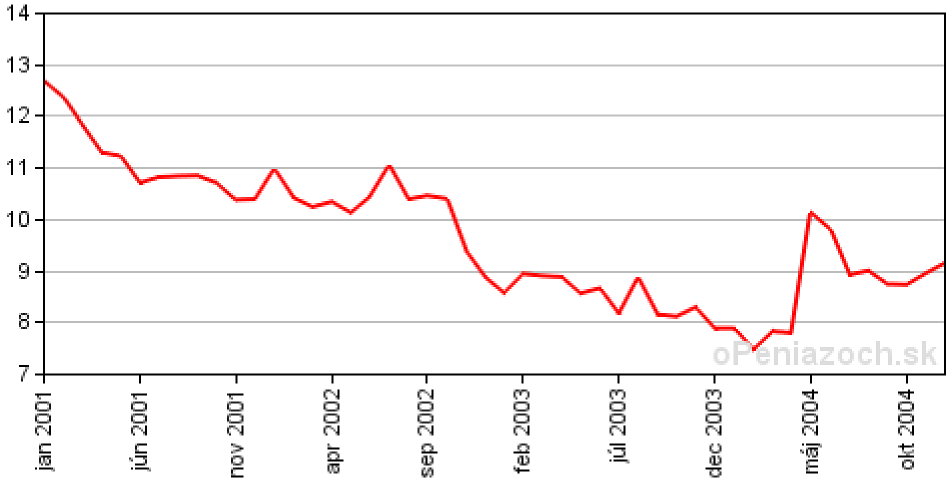
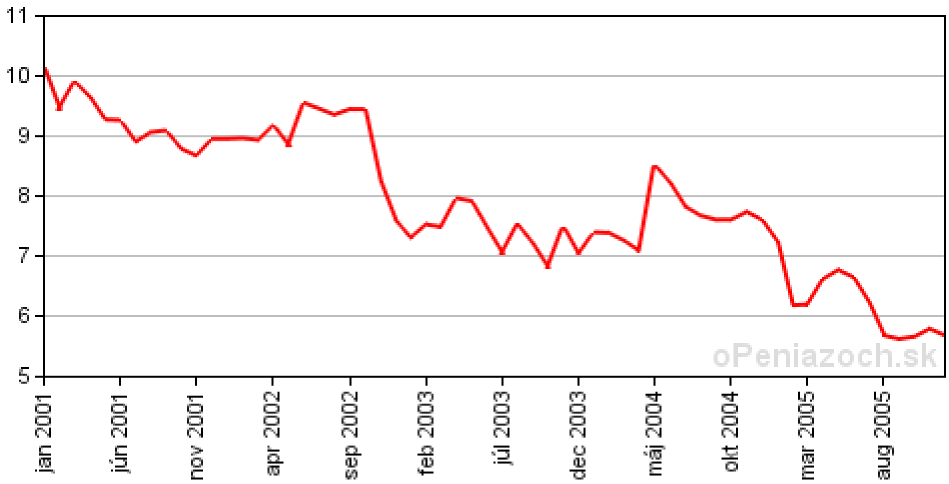


Chart 22: Interest rate of loans in the private sector.



Source: [82].

The interest rates in Hungary had similar development though they tend to be higher in recent times than they are in Slovakia.

Table 17: Long-term interest rates in Hungary in 2001 – 2005.

Year	**2001**	**2002**	**2003**	**2004**	**2005**
Interest rate	8,0	6,7	6,2	8,1	8,2

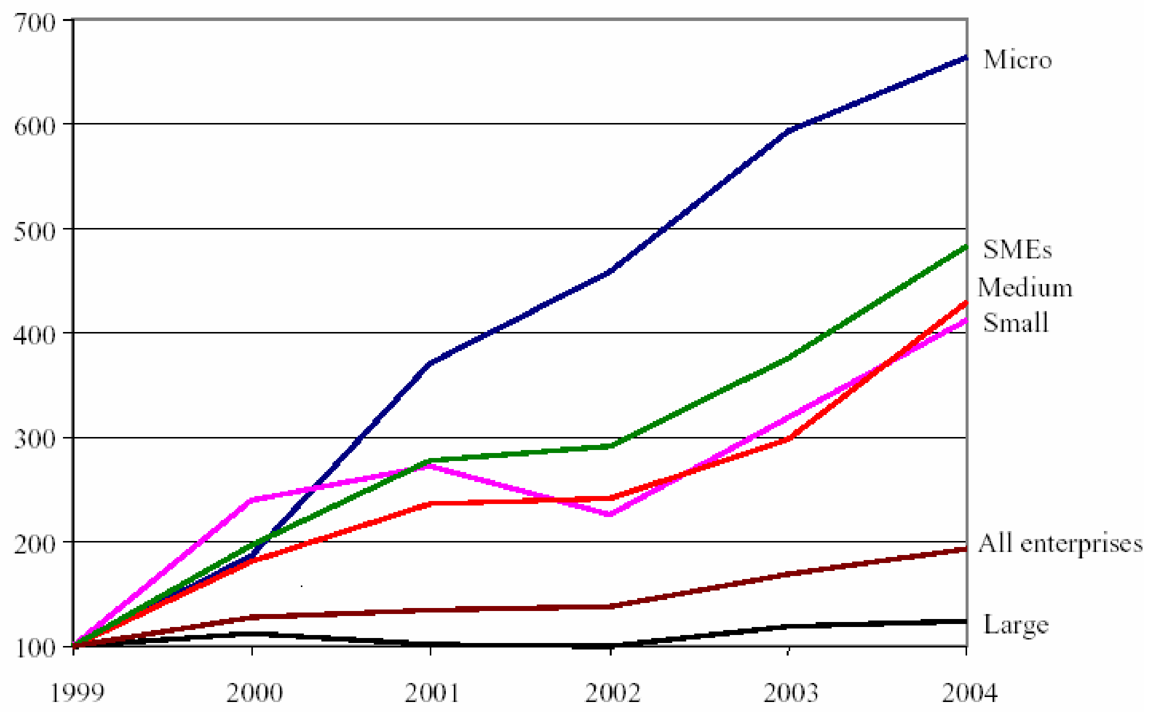
Source: [82].

Table 18: Bank loans for SMEs in Hungary 1999-2005 (EUR million).

	1999	2000	2001	2002	2003	2004	6/2005
Micro enterprises	450.8	842.8	1 667.2	2 103.2	2 675.6	2 989.2	3 042.0
Small enterprises	442.4	1 059.6	1 202.0	1 067.6	1 414.4	1 826.0	3 185.2
Medium enterprises	950.8	1 714.0	2 253.2	2 438.4	2 829.6	4 086.4	4 264.4
SMEs	1 844.0	3 616.4	5 122.8	5 609.6	6 919.6	8 902.0	10 490.8
Large enterprises	7 736.0	8 685.6	7 812.4	7 527.2	9 204.0	9 553.2	8 384.4
Total	9 580.0	12 302.0	12 935.2	13 136.8	16 123.6	18 455.2	18 875.2

Source: [88].

Chart 23: Loans provided for enterprises by Hungarian banks 1999-2004 (1999=100).



Source: [88].

One of the most important macro-level indicators of financing is the depth of financial intermediation. On the credit side, the rate of the credit stock of the small and medium-sized enterprises to the GDP has been increasing continuously and dynamically, doubling from

1999 to 2004, also accompanied by fluctuations in the total corporate credit stock. Considering that the period under study was characterised by significant GDP growth in Hungary, a clear tendency of catching-up can be identified in SME financing.

Table 19: Volume of bank credit in % of the Gross Value Added 1999-2004.

	1999	2000	2001	2002	2003	2004
All enterprises	21.02	23.35	21.78	19.62	21.90	22.69
SMEs only	4.05	6.86	8.62	8.01	9.40	10.94

Source: [87].

The analysis of the most recent trends suggests that SME crediting will keep growing: Decelerating economic growth and high domestic interest rates did not put a brake on the process of growth.

For a long time, the majority of banks were reluctant to extend credits to small and medium-sized enterprises because there had been many bad debts in this group of clients in the first half of the nineties. In recent years, the situation had improved substantially, due to intensifying bank competition. The small and medium-sized enterprise sector became an attractive target for banks.

The cooperation of banks with SME characterised low level of the competitive environment. One of the main problems was a high interest rate and lack of liquidity. Firms were just obtaining the experiences with market business in new conditions that were applied in Slovakia and Hungary. Banks concentrated on big clients and SME segment was often overseen. It was caused by few historical data from SME, few financial statements and indicators. There were only few special bank products for such wide segment and banks did not have specialists for the SMEs.

Presence is much more optimistic for both banks and SMEs. Financial need of SMEs can be solved better. Interest rates as well as liquidity allow to satisfy needs for their development as the economic environment becomes more standard and stable. Banks manage and quantify their risks more seriously. They obtain more information from firms asking for a loan. The loan administration and monitoring has improved. The prior is enterprise quality, its economic results, business plan and finally the history of firm.

Banks have a chance to obtain required information and thus to manage the risk. They have their analysts who are capable to watch closely and individually every SME. They are able to finance also their long-term needs. Banks build up special trade units in different regions for this segment. Though, it is necessary to mention that banks will always evaluate the SME individually according to the branch they are performing, from the view of entrepreneur trustworthiness and his history.

Banks focus on different clients than in the past. Their priorities have also changed:

- they focus on retail banking – small business,
- they invest into risk management,
- they invest into effective investment opportunities.

The loan market has grown significantly in Slovakia and Hungary since the EU accession. The most dramatic growth noticed retail banking. Its part became the micro-entrepreneurs. Banks offer to SME clients special products in order to increase own competitive position. It is expected that SME clients will make up to 35 – 40 per cent of the bank portfolio [81]. Obtaining the loans is also much faster for SMEs than it used to be before.

In 2002, the total amount of loans to non-banks (i.e. loans to all legal and natural persons excluding banks) consisted of an aggregated macro-economic figure that was of less relevance to the sole entrepreneur. However, it became very much an issue if an entrepreneur fulfilling all requirements for a loan application, did not get the loan because the bank was not able or willing to lend the money.

Since 2003, because of the better economic situation, banks started to focus on SME financing. At present, the banks compete intensively and try to offer SMEs products that would be acceptable for them. It means the loan procedures are being simplified, banks demand lower number of financial documents, the collaterals demanded are not so high anymore and there are even cases that the loans are provided without tangible collaterals.

However, the state is not providing wider insurance support against commercial and political risks related to export loans.

In addition to commercial banks, there are also other institutes that provide finance. The Slovak Guarantee and Development Bank (SGDB) created a guarantee and loan programmes to support especially SMEs. Its Loan and Mutual Guarantee Schemes provide bank guarantees to loans especially to those enterprises, which do not have necessary (required) amount of sustainable guarantee resources. Risk is thus distributed among SGDB, the credit bank and entrepreneur. Besides the backing of loans, SGDB also provides loans. The support consists of investment and operational capital through mid-term and long-term loans under advantageous conditions. In its loan-granting activities, SGDB cooperates with selected financial institutions. The majority of State Budget funds were channelled to financial loan-like sub-programmes, such as Loan Support Programme, Micro-loans Programme, and Seed Capital Company [83].

The so-called Enterprise Development Credit Programme for a Successful Hungary started in summer 2005, gathering several previous schemes under this brand name. Maximum credit amount available for development financing was HUF 5–1000 million (EUR 20 thousand – 4 million). So far 755 entrepreneurs received credits of a total amount of HUF 39.6 billion (EUR 158.4 million).

Guarantees provided by the Hungarian state-run guarantee organisations (Credit Guarantee Ltd. and Agrarian Enterprise Credit Guarantee Foundation) were an important contribution to small and medium sized enterprise development, too. In the last three years the state-run organisations gave collateral for 67 thousand SME credit contracts, guaranteeing EUR 2149.8 million from SMEs' loans.

Table 20: Guarantees provided from 2003-2005.

	Number of contracts	**Amount of guarantee (EUR million)**
2003	16 236	576.4
2004	25 626	848.8
2005	25 137	724.6
Total	66 999	2 149.8

Source: [87].

The group of bank loans involves loans such as:

- bank overdraft,
- Lombard loan,
- discount loan,
- mortgage,
- spanning loan,
- loan for unpaid instalments, and
- loan for a short-term consumption.

Bank overdrafts are the most often offered form of loans. Their main advantage is that they can flexibly react to changing financial needs of entrepreneur up to the level of agreed sum in the loan contract. This loan serves for a short-term repayment of discrepancy between revenues and expenditures of client. Loan limit is offered for maximum of one year. Loan is not offered for a concrete purpose and debit interest is accounted on really withdrawn sum and during real period of loan spending.

Lombard loan is guaranteed by concrete movable property of debtor. The most often used tool for guarantying the loan are securities, precious metals, art collections, etc. This kind of loan is offered to new enterprises, unknown enterprises or to the ones with lowered credibility. If the debtor does not fulfil his debts, the bank can sell a Lombard and repay its claim including the interests from the revenues.

Discount loan is based on existence of short-term security – bill of exchange that involves the unconditional written liability of debtor to repay creditor agreed financial sum in given term. Bill of exchange is usually connected with a trade loan. The nature of discount loan is repurchasing of bill of exchange by bank from its owner before the date of maturity. Bank decreases its value by discount. This is an indirect crediting of bill issuer. If the bill issuer does not repay a bill, the bank applies own claims from person that sold this bill to bank. These special forms of credit relations are applied mainly in agrarian sector.

Mortgage is a long-term loan secured by domestic real estate. The Applicant is both natural person and corporation with a seat in Slovakia. Loan is repaid by regular monthly payments at the same level made of interest and redemption [20].

3.3.2.7 Financial support programmes

There are many financial support programmes provided by the financial institutions in cooperation with the National Agencies for the SME Development. They allow an access to start-up capital mainly through the micro-loan programme and seed capital programme.

- Micro-loan programme is provided by Ministry of Economy of the Slovak Republic. The sum of loan is from 50 thousand to 1 mil. Sk. It is offered in order to allow an easier access to start-up capital to SMEs since bank loans are usually offered under the commercial base for high interest rates. The aim of this programme is to:
  - develop small businesses,
  - increase the level of small businesses survival,
  - contribute to employment maintenance and to create new jobs within the Slovak regions.

  There are only several activities that can be financed from such programme. SMEs can finance the investments or purchase of inventories, they can employ maximum 50 workers and they are small trade licences. The interest rate varies between 7 to 9 % p.a.

- Seed capital is offered to allow creation and development of SMEs. It aims to strengthen the position of SME and to contribute to their further development and to maintain the employment. Seed capital programmes make a significant part of the SME financing. Unfortunately, this way of financing is not very developed in Slovakia and other transitive economies. This programme is financed from PHARE sources and public administration budget. This form is similar to the commercial and therefore it cannot be considered as a state support. Beneficiary organisation is the one employing less than 250 workers. This seed capital means a financial investment – a capital entry into perspective SMEs. It concerns a joint establishment of enterprise or increase of basic capital by new deposit. Capital entry can be fulfilled by convertible loan. The investment period, level of obtained business share, their price and loan conditions are agreed after evaluation of the SME. Only those enterprises providing the industrial, handicraft, and travel rush activities can receive this seed capital. These SMEs must fulfil conditions such as: investment profitability, management quality, demand for own production, creation of new working opportunities, implementation and use of new technologies, favourable ecologic impacts [83].
- In Hungary, in order to facilitate the SME access to finance, credit and capital facilities were announced in those areas where the market could not satisfy the financial needs of the sector through its own means. In 2003, a multi-pillar special credit system had been set up, jointly operated by numerous commercial banks, offering graded solutions in terms of loan amounts, duration and interest subsidy matching the real demands of specific enterprise segments. Such programmes involve: Micro Credit Programme, Szechenyi Card, Midi Credit, and Europe Credit Programme for Investments [87, 89].

Most of the problems with obtaining capital show early stage enterprises. On the other hand, innovative and expanding SMEs obtain usually more financial sources. Banks play a predominant role in financing and therefore use of financial instruments depends more on the financial, legal and fiscal systems and financial habits of the country in which it operates than on other characteristics of enterprise such as size, sector, age and even profitability. According to the study on the business environment by the Business Alliance Slovakia, companies consider it crucial to use bank loans. Leasing, supplier loans and factoring follow as important financial sources.

3.3.2.8 Leasing

Leasing [2, 3, 48, 57] is also a widespread source of financing for companies. Leasing is a long-term rent of tangible or intangible staff for payment, which is in a form of leasing payoff. The advantage of leasing is that it does not tie up capital as the investment and it can be financed on 100% and there is no need for collateral. Leasing is suitable mostly for financially weaker entrepreneurs because it allows them to obtain required property without paying full value immediately. Leasing financing is considered to be more flexible comparing to loans and securities with lower restrictive conditions. Leasing company can take back the subject of leasing in case of financial troubles and lease it to another entrepreneur or it can sell it.

The disadvantage is that the implicit interest rates are in general higher compared to bank credits. Leasing is mainly used as financial instrument by SMEs in the EU countries.

There exist two basic kinds of leasing: operative and financial leasing.

Operative leasing is a short-term lease of property that gives lessor to lessee. Lessee pays to lessor agreed rent. Lessor owns the subject of leasing and he is responsible for its state during leasing, he takes care of maintenance, insurance, service and costs includes into leasing payments.

Operative leasing is generally in a form of leasing contract. It is timely limited agreed leasing, since the leased staff returns back to lessor after the leasing period expiration.

Financial leasing is a long-term lease of property and after the leasing contract expiration the ownership rights are transferred to lessee. Lessee faces all risks and possible revenues connected with leasing subject functioning. Leasing duration is usually the same as leasing subject durability. The sum of leasing payments must cover the acquisition costs of property, leasing company profit, possible interest from loan that lessor pays to bank. Leasing company does not offer any other services, but financial, maintenance, service and reparation services. Leasing contract usually contents a statement about the right to repurchase a leasing subject.

There exist three basic forms of financial leasing:

- leverage leasing,
- direct leasing,
- sale and lease back.

Leverage leasing is a 'triple-side' leasing among creditor, lessor and lessee. Lessor borrows the money from creditor in order to purchase property or its part. Bank, insurance company or other financial institutions are usually in a position of creditor. Such leasing is used when huge investments are subject of leasing. Lessors and creditors can even create a group.

Direct leasing is the one where lessor is at once a producer of leasing subject. Producer establishes a daughter leasing company that offers leasing services on his products. The advantage is that direct leasing operates without brokers and with low leasing coefficient.

'Sale and lease back' form of leasing is characterized by resale of subject by users to leasing company that releases this subject to user on a basis of leasing contract. The advantage for lessee is that the value of leasing subject occurs faster in costs than in a form of depreciation in ownership. Lessee also obtains free financial sources from sale of subject to leasing company that he can reinvest.

Leasing price

Leasing price is a sum of all leasing payments and possibly of purchase price after the leasing period maturity. The part of leasing price is an acquisition price of leasing subject, lessor profit, and interest from loan that pays lessor to bank. Value of leasing price depends on:

- acquisition price of leasing subject,
- advance payments,
- leasing period,
- leasing payments intervals,
- leasing company profit,
- loan interest rate in a case of refinancing.

Leasing coefficient shows a relationship between leasing price and common market acquisition price.

3.3.2.9 Factoring

Factoring [20] is a special form of short-term financing and it means repurchase of claims by factoring company from the initiative of claim owner (creditor). Financing is based on principle that seller transfers relevant documents about claim to factor who repurchases them and repays to seller relevant sum decreased by discount and certain fees. Factor takes over a risk of advanced invoice repayment.

Enterprise uses factoring in order to transfer the administration of claim on factor or to offer a trade loan to customer in case he has lack of own capital and therefore he needs refinancing of trade loan. There are several forms of factoring.

Factoring is defined as summary of activities and relations between creditor, debtor and specialised firm – factoring company. Its nature is to repurchase the short-term claims by factor from creditor and their due payments from debtor as well as other business-financial services.

Factoring fulfils following functions:

- repurchase of claims, e.g. financing,
- acceptance of risk from non-payment – transfer of risk,
- administration of claim accounts,
- due payments and enforcements of claims from debtors,
- realisation of additional services – advisory service and consultations.

Factoring company usually repurchases only short-term claims that fulfil former criteria. Common criteria for repurchase of claim are:

- claim does not have to be assured by bank guaranty, bill of exchange, etc.,
- claim maturity is not longer than 90 days from its issue,
- claim must be from country allowing usage of factoring,
- claim has not expired.

Factoring company pays to former owner lower price for a claim than its nominal value is. Price of claim is usually 70% to 90% of its nominal value. Factoring company decreases from its nominal value:

- discount: interest for the period of claim purchase to date of its maturity,
- risk provision: price for accepting a risk from non-payment of claim,
- payments for services: price for offered services to client.

Advantages of factoring:

- enterprise turnover growths faster than its financial possibilities,
- transfer of risk from non-payment of claim to factoring company,
- using factoring, enterprise can reach a competitive advantage.

Disadvantages of factoring:

- enterprise becomes dependent on factoring company,
- higher costs for enterprise comparing to the other forms of financing,
- it can be sign of bad financial situation of enterprise.

3.3.2.10 Forfeiting

Forfeiting [20] is mostly used in financing of exporting firms. The nature of forfeiting is repurchase of middle-term and long-term claims by forfeiting company from creditor.

Forfeiting company fulfils following functions:

- it purchases preciously specified claims,
- forfeiter accepts all risks connected with claim,
- back befall of creditor from forfeiter is cancelled,
- value of claim is immediately repaid and it is decreased by discount.

Forfeiting is a form of refinancing the export claims. Its nature is to repurchase the middle-term and long-term claims without any back befall of exporter (creditor). Bank or forfeiting company is insured by state guarantee, bank guarantee or bill of exchange.

The main task of forfeiting for exporter is a prompt reimbursement of claim that is, though lower than nominal value of claim (forfeit – fixed price). Forfeiter accepts all risks from rate flows and changes in interest rates. Forfeiting is not used by SMEs very often what should be changed by prepared supporting export programmes. Table 21 provides the differences between factoring and forfeiting.

Table 21: Main differences between factoring and forfeiting.

FACTORING	***FORFEITING***
Its nature is repurchase of short-term claims and offering of additional services.	Its nature is acceptance of middle-term or long-term claim by forfeiter.
Factoring company accepts only risk from non-payment.	Forfeiter accepts all risks connected with claim.
Contract contents all claims or group of claims.	Contract involves only preciously specified claims.
It is possible a back befall of creditor that sold the claims.	No back befall of creditor is allowed.
Price of claim depends on kind and number of claims, it varies between 70% to 90% from its nominal value.	Price for repurchased claim is very low because of long date of maturity a acceptance of all risks.
The date of maturity of claims is less than one year.	Date of maturity of claims is over one year.

Source: Own summary.

3.3.2.11 EU funds

The other important source of SME capital except of those mentioned above is the one obtained from various types of EU funds. SMEs can finance following activities form the EU funds:

- advisory and consultancy services,
- launching business using the incubators,
- hiring of buildings and places in the industrial zone, in the scientific and technological parks and services,
- first participation at the foreign business missions,
- first participation on exhibitions and fairs concerning the entrepreneurial activities,
- elaboration of studies and project documentations,
- spreading out of existing entrepreneurial activities,
- rationalisation, modernisation and diversification of existing SMEs,
- transfer of innovative and information technologies,
- support of innovative technology progresses.

Eligible EU funds 2004 – 2006

The SMEs in newly EU accessed countries like Slovakia and Hungary are obliged to use EU fund sources to finance their needs. In years 2004 – 2006 the Slovak SME were allowed to use the following sums:

Table 22: Use of EU funds by Slovak SMEs (numbers in mil. Sk).

	Structural funds	**Cohesion fund**	**Structural operations total**
2004	288,71	193,11	481,81
2005	395,85	162,18	558,03
2006	502,32	220,84	723,16
TOTAL	1 186,88	576,13	1 763,01

Source: [82].

The third hypothesis assumed that profit from own capital and bank loans with leasing from borrowed capital are dominant financial sources for the SMEs in analysed countries when providing the entrepreneurial activities.

Thesis 3: Resulting from provided facts in Tables 14-16 and Chart 23 I state that: bank loans were dominating the foreign capital as they grew in Hungary from 1844 mil. EUR in 1999 up to 10490.8 mil. EUR by half of 2005 and in Slovakia with rather similar situation with significant growth of provided loans, leasing was mainly used by micro enterprises so it did not show significant position within the borrowed financial sources. We see that second biggest growth noticed use of EU funds in both Hungary and Slovakia. The growth of provided bank loans can be interpreted by improved attitude of banks to SMEs, improved market environment with legislation compatible with the EU, and creation of guarantee banks. Profit is the most important financial source form own capital, since depreciations are only such sources that lower taxation base as far as they are included in costs and deposits of partners usually occur when SME is based. So deposits are occasional revenue while profit is long-term revenue what means continual growth and development of enterprise. The advantage of financing from profit is that it increases own capital base. Finally, enterprise thus decreases a need for foreign financial sources.

3.4 Venture capital

Venture capital [16, 22, 65, 84, 85] is relatively a new term in transitive countries. Definition of venture capital is not preciously clear.

3.4.1 Characteristics and definitions of venture capital

Venture capital is one of the most up-to-date forms of investment. Its nature is that private firms are financed through increasing their basic capital for concrete period. This is a cooperation and partnership between investor and entrepreneur resulting from former agreed conditions about both-side advantageousness.

Concerning different authors and points of view on venture capital investments, we may define venture capital in several ways. Venture capital is thus the alternative form of obtaining the financial sources for small and medium enterprises. Unfortunately, in transitive countries this form of financing is rarely used.

Venture capital is capital provided by outside investors for financing of new, growing or struggling businesses. Venture capital investments generally are high risk investments but offer the potential for above average returns. A venture capitalist (VC) is a person who makes such investments. A venture capital fund is a pooled investment vehicle (often a partnership) that primarily invests the financial capital of third-party investors in enterprises that are too risky for the standard capital markets or bank loans. For aspiring entrepreneurs looking to locate and secure venture capital they have the option of seeking the support of a mentor capitalist. A mentor capitalist is an expert not only in acquiring capital but he can also provide support and direction to early start-ups and seeds [86].

European Venture Capital Association defines venture capital as "equity capital offered by professional firms investing together with firm managers for the establishment, development, or transformation of private firms that have a growing potential. Venture capital offers support in a form of advisory in strategy. Relatively high risk is compensated by high expected revenues."

On the other hand, according to the European Venture Capital and Private Equity 'venture capital' is defined as "subset of private equity and refers to equity investments made for the launch, early development, or expansion of a business." Private equity is broader in meaning and is also used to define "external equity capital that is raised to strengthen a company's balance sheet, to make acquisitions or to finance a management buy-out or buy-in" [52, 64].

Venture capital or private equity is a financing alternative for entrepreneurial firms when traditional financing mechanisms like bank loans and other credits are difficult or even impossible to obtain. As such, private equity has developed as an important intermediary in financial markets and is especially appropriate for the financing of firms where large information asymmetries and agency problems are present [1, 28].

Venture capitalists intervene as an intermediary in financial markets providing capital to small firms with high growth potential. Venture funded firms are generally very small and young, often called innovative start-up, and are plagued with very high levels of uncertainty and an important information asymmetry between investors and entrepreneurs [7, 28]. The venture capitalists provide financial support, as equity to support fast growth, and non-financial support as guidance and expertise They may sit on boards of directors and may perform key corporate functions for the venture-backed companies or provide valuable governance and advisory support. A growing number of empirical investigations outlines the crucial importance of VC for high-tech start-up growth [11], product marketing strategy [30] and survival [47]. The aggregate role of VC in the economy begins also to be an important area of research but very few quantitative investigations have been performed so far. Moreover, survey evidence shows that more than 70% of professional investors labels accounting disclosure as the most important item which impacts their investment decision [49]. Private equity investors are intensively involved in their portfolio firms' day-to-day activities and contract a substantial number of controls like cash flow and control rights contingent upon observed performance measures. Since these private equity investors are involved in governance, they bring the professionalism into firm management except of all other positive effects described later on in dissertation.

There are many definitions of venture capital, but all of them have some same characteristics:

- investor invests mostly to basic capital of enterprise,
- targeted enterprises thus obtain required new capital,
- capital is timely restricted up to 4-5 years,
- investor reaches a meaningful long-term share in enterprise,
- the aim of cooperation of investor and targeted enterprise is a significant growth of its value and its prosperity,
- investor in agreed date resells his share in enterprise and thus his profit is realised.

Successful investment requires well-informed decision making at all levels and by all parties. At its core, good governance creates the environment for the attitudes, mechanisms and behaviours that allow this well-informed decision making to take place. Failures of governance lead to bad decisions and business failures.

Private equity investing is usually characterised by a great deal of shareholder involvement in the strategy and direction of investor. The private equity and venture capital investor takes a long-term view of value creation and is seeking, as much as possible, the alignment of shareholder interests in order to maximize value. It is important to recognise that the private equity and venture capital industry encompasses a broad range of investment situations from seed and development capital to large leveraged buyouts.

Private equity and venture capital investments follow a cycle of purchase, holding and then disinvestments. They also give rise to situations in which there is a conflict between the competing interests of various parties to a business, transaction or negotiation.

In developed economies, in which the capital price oscillates around 10%, investor's yearly profit is estimated around 30%. Since the investor brings not only capital but also specific knowledge and experiences that should be applied in enterprise and it is a long-term cooperation of investor with firm management, it is not an easy process.

This form of SME financing differs from all other ones. For example, there are no guarantees needed comparing to bank loan. The most important is creative and perfect business plan which is prepared and realised by capable enterprise management. On the other hand, investor has to face a risk. Decisive motive for investor for such way of investing is reaching the highest profit as possible and increasing the share value in enterprise.

Investor does not become manager and he even does not manage basic enterprise functioning. He rather influences strategic decisions with a right to veto.

Good corporate governance should follow several principles:

- conduct of business should always be in accordance with applicable laws and regulations of the jurisdictions in which business takes place,
- it should act with integrity towards investor and shareholders,
- it should offer such investment solution that establishes a relationship in partnership with investor that is defined by negotiated, mutually agreed rights and responsibilities for all parties,
- it must create a value by taking long-term view of investment and supporting management in the achievement of long-term objectives and strategies,
- it must respect the interests of shareholders, including investment fund providers, the fund manager, the board of directors, company management, employees, customers, suppliers and others,
- it should be provided transparently in order to maintain success that depends mainly upon clear disclosure and timely communication of relevant and material information to facilitate highly quality decisions,
- it should treat obtained information from company as confidential and cannot use these information in away that may be detrimental to company.

Venture capital is directed mainly to SMEs where it plays similar role as capital market for big corporations. This venture capital includes:

- investments of venture capital,
- investments of developing capital.

Venture capital (starting capital) means investments to basic capital of newly established enterprise. Its main task is to establish and further develop the enterprise or to realise a promising business plan in practice.

Developing capital includes investments into existing enterprise with lack of own capital for the development and realisation of new ideas.

It is not correct to mix the venture capital funds with investment corporations or banks. This perception is incorrect and misleading. Venture capital funds focus on concrete specific projects. They emphasise knowledge and experiences of managers, perspective business plans, attractive branch, and growing potential of enterprise.

The key criterion is fast investment return and its high profitability. Enterprise is under detailed analysis and audit before it receives venture capital.

Venture capital funds choose the enterprises on a basis of:

- creative and viable ideas,
- quality of business plan,
- quality of top managers,
- perspective branches.

Venture capital is not unified. There exist several forms and kinds of venture capital. Suitability of each kind of venture capital is given by many factors:

- life cycle of enterprise,
- ownership relations,
- economic situation of enterprise,
- planned use of investment.

The most common division of venture capital is its division according to the investment phases:

Seed capital is connected with launching phases of business, often before enterprise is established. This kind of venture capital focuses on market research financing of new product or service, financing of development of new products, financing of business plan administration, etc.

Start-up capital focuses on financing launching entrepreneurs. Investor offers his capital to enterprise that already has business plan, quality management and organizational structure and wants to achieve market with own production programme.

Invested capital varies between 4 to 20 mill. Sk. Its return is expected in 5 to 10 years.

Early stage development capital focuses on financing of entrepreneurs who already exist less than three years and have not reached high profit yet. They are able to develop but they are not able to obtain enough financial sources. Investments to these enterprises are connected with smaller risk. Despite of it, risk is rather big and return of capital varies between 4 to 7 years. Invested sums are between 10 to 40 mill. Sk.

Later stage development-expansion capital means investments to enterprise performing for a longer period and with potential for further expansion and development. This capital finances new products, penetration to new markets or strengthening the market position through various marketing tools. Risk of such investment is much smaller comparing to former cases and the period of its return is shorter, in average 2-5 years. Typical investment is around 20 to 80 mil. Sk. These investments can be provided by strong venture capital funds.

Rescue capital focuses on offering the financial sources to rescue an enterprise before bankrupt. This kind of venture capital is not very common and its necessary condition is connection of enterprise rescuing with starting up a re-development. Rescue financing requires management change. Company willing to obtain this capital must have a developing programme that would sustain its constant growth.

Acquisition capital serves to buy the other company, or the part of company. Capital serves to change the ownership relations in the company. Risk is rather small because these are the investments into existing enterprise which economic indicators, parameters and results are well known to investor. Special form of acquisition is repurchase of enterprise by its management. Present or future management (buy-out management or buy-in management) repurchase existing and functioning enterprise. This repurchase cannot be guaranteed by the enterprise property and thus management uses venture capital fund. Since price is paid by the enterprise itself, acquisition capital concerns highly profitable enterprises.

Debit replacement capital is applied in enterprises with high foreign sources share. This high share can possibly cause troubles to enterprise because of high interest costs. Should this interest costs be the only significant obstacle of enterprise development, use of this form of venture capital is a very good solution. The nature is that foreign sources are replaced by own capital obtained from debit replacement financing.

3.4.2 History of venture capital and existing investigations

The first signs of venture capital were noticed on threshold of 19th and 20th century, but the very first venture capital funds accumulating capital were established after the World War 2nd. Expansion of investments occurred after 1976 and was connected with taxation and legislation changes in USA. First years of expansion touched the investments into modern technologies in informatics, genetics, or pharmacies. The second phase was dominant by developing capital and repurchase of shares. Current period is characterised by variability of venture (equity) and developing capital, by combination of various financial methods and tools.

The first steps and signs of venture capital within the Middle and East Europe were realised after 1992. First investors from USA and Western Europe brought new forms of capital [16, 65].

A number of factual evidences on the economic impact of VC have been published by specialized institutions, especially for the US economy. According to a study carried out by DRI-WEFA1 on US VC-funded companies over the period 1970-2000, "venture capital-backed companies had approximately twice the sales, paid almost three times the federal taxes, generated almost twice the exports, and invested almost three times as much in R&D as the average non-venture capital-backed public company, per each $1,000 of assets" [84]. The same study also shows that VC fosters local and regional economic growth in the USA. The European Venture Capital Association [84] argues that venture-backed companies stimulate the economy through the creation of jobs, their exceptional growth rate, their heavy investments and their international expansion. VC is considered as a factor decreasing substantially the required time to introduce an innovation on the market. Empirical investigations on the impact of VC on firm's performance have been performed at the micro level. Hellmann and Puri (2000) implemented a survey of 149 recently formed firms in the Silicon Valley. Their empirical results suggest that VC stimulates innovative activities of firms. A start-up financed by a venture capitalist needs less time to bring a product to the market. They also show that firms pursuing an "innovator strategy" potentially have better and quicker access to VC funds [30, 85].

Engel (2002) shows that the surviving German venture-backed companies seem to achieve significant higher growth rates due to financial involvement and services provided by venture capitalists. The author also shows that the impact of VC on new firms' growth rate does not differ between high-tech and low-tech industries. Hellmann and Puri (2002) also examine the additional role played by venture capitalists compared to traditional financial intermediation. The authors focus on the development of 170 young high-technology firms in Silicon Valley. They find that venture capitalists intervene in a huge range of activities that are important for the professionalization and development of a start-up company [30].

Kortum and Lerner (2000) perform an aggregate evaluation of the relation between VC and innovation. The authors examine the influence of VC on the propensity to patent inventions in the US from 1965 to 1992, with 20 industries and 530 venture-backed and non-venture-backed firms. They find - with a wide variety of specifications - that VC activity significantly increases the propensity to patent, to a much larger extent than corporate R&D. They further show that while from 1983 to 1992 the ratio of VC to R&D was on average smaller than 3%, VC may have accounted for 8% of industrial innovations during the same period [42].

The recent analysis of Ueda and Hirukawa (2003) focuses on the causality issue of VC investments and innovation in the US manufacturing industry using Multi-Factor Productivity (MFP) growth as a measure of innovation. They find that MFP growth is significantly and positively associated with subsequent VC investments. They add that in computer and communication sectors VC has an impact on innovation and innovation has an impact on VC. On the other hand, in drugs and scientific instrument industries, they find that MFP growth and VC investment are often significantly and negatively related [59].

Audretsch and Keilbach (2002) perform an aggregate analysis and evaluate the impact of entrepreneurship capital on the economic performances of German regions. Their results indicate that entrepreneurship capital (proxied by the number of start-ups in a region, relative to its population) is a significant and important factor shaping output and productivity. This paper follows the similar objective by employing VC as proxy of entrepreneurship capital. [52].

3.4.3 Venture capital market participants

Venture capital market does not belong to the greatest parts of world financial markets but dynamics of its development is one of the greatest within the area of investments and international financial flows. The main participants of the venture capital market are primary investors, targeted enterprises, venture capital funds, management companies and specialised companies called ‘catalysers’.

Primary investors are mainly big and strong financial institutions such as banks, pension funds, investment funds, insurance companies and other institutional investors with free capital.

Targeted enterprises are mainly launching enterprises (seed and start-up capital required), developing firms (developing capital required), transaction enterprises, and revitalizing enterprises (rescue capital required).

Venture capital funds concentrate capital from investors and offer it to targeted enterprises. They create an investment portfolio which they administer and manage.

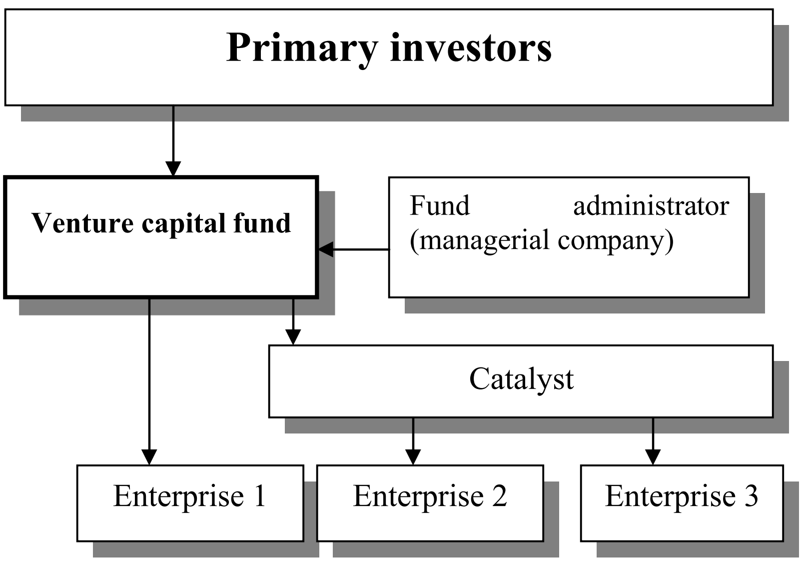
Management companies investigate, analyse, realise, monitor and make investments.

C*atalysers* have their clients who seek for the investors. Catalysers deal with the management companies administering the venture capital funds or they can even match direct investments.

Performance and successful investing at the venture capital market is complicated and highly professional process that requires qualified and experienced specialists. Venture capital investment has developed in a complicated investment tool, which requirements for controlling deserve high level of organisation in most of cases. These are the reasons why investors set up venture capital funds. This fund is a company serving to accumulate capital from investors. From Figure 5 results that fund becomes shareowner of targeted companies after investment transfer.

Portfolio manager remains fund administrator (management company) representing fund. Fund usually hires professional management company that judges the investment opportunities, makes a choice, monitors and administers portfolio and finally it sells own shares in each targeted company. Managerial company offers these services on a basis of contract. Since managerial company provides every common administrative activity and technically manages the investment process, its attitude to targeted companies is the one like to investment objects.

Figure 5: Basic structure of venture capital.



Source: [16].

Primary investors are important participants of the venture capital market and owners of free financial sources required for the investments. For most of the big institutional and corporation investors performing internationally, the investments into venture capital funds mean only a small part of their investment activities. Big investors create investment portfolio.

Decision about investments into venture capital fund is complicated and requires detail analysis. Investor has to answer questions as:

- What capital to invest,
- What fund to choose to invest,
- What will be the profit and what will be the period of investment return,
- How the investments will be controlled,
- What will be his share on management and decisions.

Since venture capital funds are created, the investors do not have to deal with technical questions concerning investing and control. It is important to provide detailed and quality analysis before the investments to concrete fund are realised. This investment is characterised by low liquidity and relatively high risk, but it promises a high profit. This is a reason why experienced investors do not invest to venture capital fund big volumes of capital.

Portfolio structure of big institutional investors such as share funds and pension funds is regulated and controlled in the developed economies to avoid loosing depositor's long-term savings.

Legislation forces investors to keep rules of cautious investments and to regulate risk. It is clear that criteria for structuring the investment portfolio from the view of profitability, liquidity and risk will be different for the pension fund, which financial flows are predictable for many years to come, for the share fund, bank and for big corporation investors.

There are many kinds of subjects investing to the venture capital in the developed economies. The nature of capital can significantly influence the structure of whole investment transaction as well as work style of investment managers.

Financial sources from state (typically in Europe), from private companies (typically in the USA) or even from natural persons are common sources of venture capital.

Institutions dealing with SME support can establish venture capital funds. We can classify the venture capital investors according to the several criteria such branch structure, invested capital volume, development phase of targeted company.

The other important criterion of investor classification is a capital source:

Independent investors: investing subjects that created capital from big volume of sources. Here belong mainly big financial institutions such as pension funds, share funds, banks, or insurance companies. Independent investors are not legally connected with subjects which offered them capital.

Dependent investors: investing subjects which are subsidiaries or organisational units of bigger institutional investors, mostly of banks, pension funds or other financial institutions. They obtain capital from controlling company.

Partly dependent investors: are the combination of both former investors. Partly dependent investors administer capital of their controlling company but they also have another capital sources obtained independently from controlling company.

Trade angels: are natural persons investing their own capital. These investors can create an investment consortium to diversify risk. Some trade angels can invest directly to targeted companies. These are the examples of silent partners.

Institutions with state support: are such venture capital investors that obtain directly or indirectly capital from government budgetary sources. They are usually specialised institutions supported by state.

Targeted companies.

Targeted companies (clients) are persons interested in obtaining the investment. They are mostly the SMEs with lack of capital to realise own business plans.

Every targeted company should answer the following basic question:

1. How and when to interest in venture capital investment?
2. What level of independency from venture capital fund to maintain?
3. How to cooperate with venture capital fund after investment realisation?
4. How to solve conflict and critical situations?
5. What will be the conditions to finish cooperation with venture capital fund?

The first step to obtain venture capital is to request a venture capital fund. Targeted company chooses such fund that is interested in requested investment. Fund has to be able to invest in given country or region and it must be interested in given economic branch. Targeted company must be in such development phase that corresponds with investment focus of fund.

Targeted company is rarely specialist on investment problematic. This can be reason why targeted company seeks for perfect advisory services. It is important because entrepreneur has to agree on detailed conditions of cooperation with venture capital fund. It is very suitable to offer to venture capital fund representatives basic information about enterprise, its management and basic information about business plan. This written document can fasten the whole process or it can warn the entrepreneur that his plan does not correspond with fund's investment criteria.

Entrepreneurs should not forget also the protection of information and they should sign a deal about information protection because important and secret information could be otherwise published and used by competitors. Entrepreneur minimises risks and thus becomes fair client for the venture capital fund and decreases possible conflicts and misunderstandings of both-side cooperation.

Venture capital funds [16, 65, 84].

Venture capital funds are decisive institutions in a process of venture investments. They are in a position of 'agents' between primary investors and targeted companies awaiting the investments. They provide fast transfer of financial capital from those who lend to those who borrow.

Investors deliver their capital to venture capital funds to have them perfectly invested and highly returned.

Very important factors for primary investors are risk level and liquidity that funds can guarantee them. Obviously, investors expect the soonest payback period as possible as an important factor in their investment decisions.

The most important tasks and functions of venture capital fund are:

- investigation and obtaining the biggest number of potential primary investors as possible willing to invest to fund,
- investigation and obtaining the biggest number of potential clients wiling to obtain venture capital investments,
- analysis and choice of potential investment opportunities that best serve to fund's investment criteria from the view of whole branch area, profitability and risk,
- realisation of chosen investment projects and assuring all legislative and other requirements,
- monitoring, management and control of each investment project, solution of critical and conflict situations,
- realisation of fund exit from enterprise (sale of share) in given date and thus obtaining invested capital with extra profit.

Classification of venture capital funds is based on capital nature that is used in the investment process. Big corporations or financial institutions usually create private venture capital funds to support entrepreneurs and to get high revenues connected with risk investments.

Private funds hold more free capital than government funds, though. Private venture capital companies are exemption in Europe comparing to USA. Their founders are usually former bank employees with good reputation and they are able to gather enough capital. Since venture capital supports smaller enterprises, state institutions for the SME support often establish the venture capital funds.

Government fund investments are restricted in certain cases. For example, they cannot offer capital to enterprises controlled by state, they cannot invest to casinos, night clubs, tobacco producers, alcohol, or weapons.

Venture capital funds holding private capital apply their own criteria to choose suitable targeted companies.

In general, funds holding private capital are interested in companies and projects fulfilling these characteristics:

- private enterprises with lower than 50% state ownership share and without strong state control,
- no foreign capital partner involved,
- complex business plan,
- complete and trustworthy management with clear good results of activities provided,
- they require marginal capital to invest or to increase operative capital (inventories and claims) resulting from growth of earnings,
- they have growing demand on domestic or foreign markets,
- positive impact on employment and life environment.

Managerial companies.

Managerial companies provide own investment activities. Venture capital fund hires the professional managerial company that evaluates investment opportunities, makes a choice, monitors and administers portfolio and finally provides also resale of held shares in each company. Managerial company offers these services on a basis of contract. It receives payoffs for provided services. It shows the relation amongst investors, funds, managerial company and investment beneficiary – targeted companies.

Fund becomes shareholder in targeted companies after the investment is transferred. Managerial company provides the portfolio administration, though. Relation between fund and managerial company is usually written down in contract about offering the advisory services. It is important to distinguish strictly the role of managerial company from investor.

Managerial company provides all administrative technical works connected with investigating the investment opportunities, their checking out, realisation of investments, monitoring and analysing of investments. Though, investor representatives make a final decision about the investments. Therefore, venture and development capital fund has an investor committee which definitely approves or omits the investments. This investor committee is an external department which does not have full-time employees.

Catalysers.

Catalysers (consultants) search for the venture capital companies so that private capital fund managers would not waste a time by analysing these transactions that would have only few chances to succeed according to submitted documentation.

Every fund has its own preferences in branch and interesting investing areas. Consultants can advice to entrepreneurs how not to waste a time requesting the capital from funds not suitable for them.

Searching for the capital is a tough process requiring time and money. Negotiations about capital entry are even more intricate because investor needs assurance but he has no chance to ask for the guarantees for offering the capital. This advantage or disadvantage occurs only in a case of bank loan financing.

Consultants have to be aware of private capital market, they have to know well the private capital problematic and they must have experiences with successful and unsuccessful transactions. The most important is to know the criteria and functioning of each fund.

Financial flows within the venture capital.

Financial flows connected with the venture and developing capital investments are very variable. Revenue division depends mainly on agreement between investors. The most common financial flow structure is a Limited partnership.

Financial flows can be divided into three basic levels:

- financial flows from view of investors,
- financial flows from view of managerial companies,
- financial flows from view of venture capital funds.

Financial flows from view of investors.

There are only two kinds of financial flows important for the venture and developing capital funds investors. The first investment phase is characterised by withdrawing the underwritten capital. The most of funds prefer invoking the capital as required. It means that required capital that is to be invested is received 'per partes' equally during the investment period. Investors approve required investments when they are necessary in targeted companies. Some funds have strict subscription period. It is commonly required to invest small sum (e.g. 10%) when fund is created. This capital covers fund establishment and other newly emerged costs.

Final phase is characterised by resale of revenues. The first revenues are realised usually in the fourth and fifth year of fund existence. Algorithm of revenue division is quite flexible. Investor's interests are satisfied as first until invested capital returns or invested capital plus hurdle. Hurdle level is derived from anticipated inflation. Remaining revenues are divided between investors and managerial company according to stated formula. The most common way of division is 80% for the investors and 20% for the managerial company. The majority of funds divide all revenues among investors as soon they receive them. The revenues are divided once or several times per year.

The investment managers can decide whether to divide the revenues or to increase the underwritten capital by these revenues. Though the fund durability is generally ten years, the average investment durability varies between 5 – 6 years from the view of investors.

Financial flow from view of managerial companies.

The economic activities of managerial company are tightly connected with the financial flows of administered venture and developing capital. Managerial company obtains a management fee that is defined as fixed percentage from the volume of administered assets and it also obtains certain share from reached fund capital valorization in a form of success fee. This share is usually called carried interest.

Management fee oscillates around 2.5% p.a. from underwritten capital. Its precise level depends on fund size. The great world funds have usually 2% management fee, small funds focusing on start-up capital exceed it over three percent. In certain case this fee can be indexed. It is common to state a commitment period after which:

- the management fee decreases (e.g. on 1.5%),
- stated percentage is related only to sum chosen to the end of this period.

Carried interest is generally 20% for the managerial company. In most of cases carried interest is deduced from fund's results. It means that these interests are repaid only when investors obtain back the investment plus hurdle. The standard revenue is 9-10% so that carried interest is repaid only when internal revenue percentage exceeds standard revenue. It is required that yet unsold investments be evaluated and verified whether their value is not lower than anticipated value.

The aim of carried interest payments is to involve the financial management team on the highest fund valorisation as possible and its long-term motivation. This is a reason why many investors require that at least 50% sometimes even 75% from revenue share would be divided directly among the investment managers and other managerial company members. If managerial team member decides to leave it he must disclaim a certain profit share. It depends on reason of his leave and period spent in a company. On the other hand, new member obtains certain share depending on period of entering the company. In case managerial company ends its activity, profit share is usually not repaid.

Managerial company receives also another fees accept of profit share and management fee. These fees are usually received from targeted companies. Their level is not so important than first two mentioned incomes. These fees can include salaries for members in targeted companies organs, underwriting fee, syndicate fee and fees from not provided investments paid by client company. Though the managerial company receives several fees, investors sometimes deserve to transfer them in a favour of fund.

Financial flows from view of venture capital.

Financial flows from view of venture and developing capital include most of mentioned financial flows. Except of these flows fund faces also another costs related to its activities. They include audit fees and overhead costs connected with the investment committee performance.

The question to be discussed is whether these costs should load fund and investors or whether managerial company should pay them from obtained management fee. Investors request managerial company to pay these fees in order to participate in fund. It mainly concerns those funds focused on transactional capital. Many investors also request that managerial company should pay also fees from unrealised investments.

The other opinion is that these costs could cause caution of managerial company and thus decrease fund revenues. The area of organisational costs that are applied when fund is created is very variable. Funds usually accept these costs up to 1% from underwritten capital at the beginning of fund existence.

3.4.4 Economic impacts of venture capital

Investment fund should provide concrete forms of revitalisation and re-structuralisation of the industry. Venture capital fund obviously contributes to:

- higher annual revenues,
- higher employment within the enterprise,
- higher investments to buildings, tools, and financial instruments,
- higher state budget revenues due to taxes paid, new trade and export opportunities, widening of labour opportunities and imperfection of business itself,
- expertise and scientific skills and thus help to grow and development. [60]

All these effects and expectations are conditioned by neutralisation and overcoming of various risks of funds' activities led by fund manager:

- fund manager should focus more deeply on information about the enterprise and work out more complicated contracts than bank capital deserves,
- implementation of venture capital is connected with several obstacles such as temporal sharing of ownership and decisions, temporal lost of independence and huge outflow of information for new partner.

Funds should respect the investment policy of enterprises and propose the suitable form of revitalisation and restructuralisation. Since 1999, research dealing with the economic impact of venture capital was elaborated, and therefore we can show following evidences of stated Hypothesis 4:

- the revenues after the venture capital entry into enterprises were doubled comparing to those SMEs without such investments,
- the number of employees usually growths faster and in significant numbers (app. 15% per year),
- the investments into equipments, buildings and financial tools grew by one half,
- development of venture capital in enterprises has brought higher revenues in state and municipal budgets from taxes, it has brought new trading and exporting facilities, venture capital growth accelerated the employment,
- venture capital funds offered the expertise aid in enterprise development.

Companies applying the venture investments stimulate the economy as whole:

- They show a fast growth – such investments are rather new in this territory and therefore it is bit difficult to evaluate their whole impact on economy, but they noticed faster growth of turnover than 100 other most meaningful enterprises within analysed region.
- They invest intensively – they invested almost three quarters of whole turnover by 2004. Research and development costs showed growth in more than 50% of companies.
- They export – growth of export in venture financed firms was more than one third and meant almost one quarter of all their revenues since 2000.

Venture capital investors are attractive partners because they offer financial and non-financial aid to SMEs:

- they offer capital allowing fast growth of SMEs,
- they offer leadership and experiences,
- their contribution is usually evaluated positively.

3.4.5 Analysis of SME financing from venture capital

Anecdotal evidence and academic studies show that private equity investors screen potential entrepreneurial companies extensively before deciding to invest in the company. Selection only takes place when a firm successfully passes an initial screening round and a more thorough due diligence process [64].

Investment process concerns the first contact with potential client, evaluating of the business plan and finally it involves realisation of investment project. Process has different durations depending on client readiness and quality of delivered statements. Investment process consists of continuous activities. The main differences in these activities occur in level of formalisation of the investment process, in a form and range of used documentation and in transfer of equilibrium between collective responsibility of the managerial company and individual responsibilities of managers.

We argue that venture capital spends a lot of time and sources for the analysis of enterprises in order to find the best opportunities for business. The process of risk elimination contributed to the development of implicit models that are helpful in decision-making and investment processes. Entrepreneurs have to realise and understand that these models are part of their effort to obtain a capital.

Though venture capital represents only a small percentage of total amount of invested capital, these investors meaningfully influence remaining investor categories. Their evaluation is one of the indicators that should be involved in business opportunities evaluation.

This area is rather complicated, therefore investor has to consider meaning and importance of great number of individual indicators and evaluations such as market potential, enterprise financial results' prognoses, managerial skills etc. Indicators provide whole investment overview and lack of information and data could possibly contest the final investment.

Investment criteria can be classified into seven groups:

1. **Product – market:** it concerns the nature of product and market, i.e. predicted market size, level of growth and season.
2. **Strategic – competitive criterion:** it concerns the traditional terms of strategy and competition dynamics, strength of suppliers and distributors, ability to create barriers for the new potential market competition entry.
3. **Enterprise management:** it concerns managerial skills, former activities of top businessmen and managerial team.
4. **Managerial qualifications:** they concern organisational and managerial skills in the area of marketing, sale and production.
5. **Financial criterion:** including time necessary to reach equilibrium and to prognose investment return.
6. **Criterion of fund:** it reflects relations of opportunities to make business. Venture capital investor must think of his portfolio and liabilities of investors to fund portfolio from the view of realised investments.
7. **Transaction:** it concerns the investment specifics, enterprise development stage and ability to create consortium to realise the investments and further investing to maintain constant investment growth.

European venture capital investors generally use the same model of potential investment evaluation. Generally, managerial and personal qualities have the greatest share. Venture capital investors are interested in entrepreneur's and managerial team's leading and management skills in order to realise the investment in practice.

Financial prognoses are also of great importance but their share is not so big than managerial team and investment opportunity. Financial prognoses are realized when good business plan become real. The character and level of competitors on the market are not so relevant like clear managerial capabilities to sustain and protect its investment and market share. The most important is what makes who. Not how and where he makes it.

The entrepreneurs must prove their leading and managerial skills and necessary qualification to potential investors. They should submit a clear product and market strategy. Except of this, they must ascertain they are submitting trustworthy financial statements and data and real investment return.

First judgment of the business plan.

Investment decision depends on detailed analysis of whole investment intention. There are some cases where we can immediately justify whether the investment intention fulfills investment criteria and whether it has potential for a further cooperation. Though, initial investment justification can last for a longer time depending on investment complications and abilities to check all requirements.

The first stage of cooperation reflects reconciliation with key fund criteria. Fund must recognize the capital level deserved by company, investment objective, ownership structure, management results, overview of the products' competitive advantages and present and historical company results.

In case investment strategy reflects the company's needs, investment process is preceded into the second phase and investor announces project investment.

Motivation scheme.

Venture capital fund is interested in a successful enterprise development. Investment manager suggests a 'motivation scheme' in his indicative financial offer. It contents the opportunity to repay a silent partner and to repurchase the priority shares. Since the indicative financial offer is signed both partners express willingness and interest to continue the cooperation under agreed conditions. It is not a duty for the venture capital fund to offer financial capital and at once, it is not a duty to company to provide secret information.

Indicative financial offer.

The first fund's financial offer is indicative. It expresses a serious interest of both partners. There are several important data in such offer:

- **financial sources:** they are divided on bank loans, leasing, private investor's capital, and venture capital fund finances.

- **fund investment tools:** fund specifies the forms of own entry. The way of risk treatment and its restriction and conditions for ending-up an investment are different. There are three ways of capital entry:

1. *fund entry as enterprise partner* specifies the level of sources exceeding the basic capital and business share levels. It is necessary that basic capital be repaid in full before the fund entry. Voting rights and profit shares are also specified.
2. *fund entry as silent partner*. Silent partner is the best control tool in the enterprise. It specifies the level of deposit, silent partner profit share and ways of its repayment. Silent partner can obtain a 'veto' right in several concrete investment decisions.
3. *loan to fund.* The part of capital can be in a form of loan. It is specified sum, interest, duration and level and terms of principal.

Since every enterprise needs different sum and capital targets, these three basic forms of financing are usually combined. If enterprise agrees with the content of indicative financial offer the process of due diligence begins. The main task of due diligence is to find out whether given business plan is real.

There are several conditions stated in the indicative financial offer that have to be sustained during due diligence. Venture capital can avoid a contract when the conditions are not fulfilled. On a basis of information obtained during due diligence a preliminary project evaluation is elaborated. This evaluation is submitted together with business plan and financial statements. They can either approve or disagree with a project.

Due diligence.

It is necessary to emphasise that checking process provided by evaluation of submitted business plans is absolutely different from those applied by banks. Investment manager of venture capital fund evaluates such projects that have no or minimum history. Many of submitted data result rather from prognoses of project author and are often influenced by his subjective justification.

Therefore, the most important role of investment manager is to recognise the ability of enterprise managers to run the project in practice. The other task is to distinguish subjective prognoses of entrepreneurs from the real abilities of future development and to find out growth potential of the enterprise.

Reason to provide the checking procedures is to search for information concerning the project. There are several information sources used in this analysis such as Internet, branch analyses, opinions of specialists, case studies, etc. Verifying focuses not only on the enterprise itself, but also on its competitors and whole branch in which company provides the activities. Investor evaluates whole branch growing potential, technologic changes in a branch, he compares situation in the country with world tendencies, developing tendencies in a branch, he checks the legislation, state of the main competitors on the market, their strengths and weaknesses. This part of verification is important to create an objective opinion of business aspects in given branch.

Another part of verification process is to analyse the economic data of business plan such as balance sheet, income statement, and cash-flow. The aim of the analysis is to disclose possible failures in the economic statements and to identify potential crucial places in the enterprise functioning. It is also analysed whether planned economic results are attainable.

Investment managers also investigate data about project submitters, their past business activities or personal references. They also analyse a company: its business activities, property, partners, supplier relations, etc. The results of these analyses are generalised in the General Risk Analysis. Investors often use the cooperation with psychologists who are to judge the managerial qualities and skills, suitability and readiness of current enterprise management.

Proposal approval.

Different types of private equity investors often generate different types of deals, particularly because both the professionalism of the screening and monitoring activities are determined by investor type [7, 63]. Since a firm's disclosure behaviour is likely to be associated with the extent and intensity of its screening and monitoring efforts, one can question whether the disclosure policy of private equity portfolio companies is affected by its investor type.

Since checking process is finished and its results are acceptable for both sides, the "Investment contract" is signed. Signing of the investment contract requires the change of data in Commercial register, underwriting of new contracts among each managers and participants within the commercial or production group.

According to the contract, entrepreneur deposits on investor account certain capital, e.g. 2% of anticipated invested sum [43]. Applying of this action means that entrepreneur would not obtain or abuse investor analyses without contract. If the investor decides not to entry a company, he will repay a deposit.

The whole investment process can last from one up to three months. Generally, period from accepting till approval depends on number of obtaining required information from the company and from complexity of investment and financial backgrounds.

Monitoring.

The main task of monitoring is to obtain relevant information about the enterprise and to fulfil goals of the enterprise.

Whereas the pre-investment period is typically dominated by information asymmetries and adverse selection problems, the mutual relationship which arises between the entrepreneur and its private equity investor after the private equity investment is subject to potential agency conflicts and moral hazard problems.

In this phase of the investment process venture capital fund behaves as a real entrepreneur partner. Fund usually consults the strategic, financial and personal management, planning and further tasks. After investment contract is signed it is possible to get several positions within board of directors and supervisory board. Fund managers do not become members of management, though. They only participate in discussions about the strategic questions. Their main task is monitoring the enterprise progresses in fulfilling the business plan. Enterprise managers have to submit following documents:

- monthly financial statements and accounting statements,
- yearly audits,
- yearly budgets,
- overview of liabilities and commitments.

Fund always uses all sources including the technical support in order to contribute to successful enterprise development.

Realisation of investment – exit.

Venture capital funds are commercial subjects and their main goal is to obtain profit. They sell owned property shares. This fund operation is called enterprise exit.

Existence of tools allowing the venture capital funds effective evaluation of invested capital is a vital element for the activities. The most often applied tool is sale of the enterprise on capital markets or sale to strategic partner.

Though every exit is specific, generally we can conclude that there exist four basic opportunities for the exit:

- repurchase – co-owner or enterprise managers repurchase back shares from investor,
- refinancing or sale to institutional investor focusing on long-term investments such as share funds, pension funds, etc.,
- initiating public offering on capital market,
- involuntary exit by liquidation of the enterprise.

Sale to strategic investor.

Firms not fulfilling the requirements for providing business at the stock usually choose private placement. It is a cheaper way for the exit than initial public offering (IPO) since no additional fees connected with share emission or quotation on stock are required. Disadvantageous is lower share value determined in contract between enterprise and investor.

Placement on stock.

The other opportunity is placement of the enterprise on public market by start-up or IPO. This step usually called 'going public' can bring a big marginal capital. At once, in case of mistrust of investors it can cause a bankrupt.

The IPO brings also further advantages. Successful public offer can produce higher price than private one. IPO increases basic capital as well. Shareholders have a chance to resell their shares and get back certain part of investment. They do not pay any principal or interests.

Firm has to provide several important changes before the emission. Its accounting statements have to be audited and they have to face stock standards. Due diligence has to be done as well.

Repurchase.

Enterprise management repurchases shares from investor after the investment period is over mostly by loan or further financing by transactional capital.

Involuntary exit.

Involuntary exit is the worst possible alternative for investor. There can always happen unpredictable events. The only opportunity to solve this situation is to save the greatest volume of capital as possible.

Evaluation of the investment.

Evaluation of the investment means comparing the amount of investment when investor enters the enterprise with its value on exit. This evaluation must include a capital time value. Internal rate of return is mostly used in the evaluation process. Its advantage is simplicity of calculation of the internal rate of return. It can be called as interest rate in which present value of financial flows incoming to investment equals the sum of present value of financial flows exiting the investment.

Value of the internal rate of return can be commuted from following formula:

$$I - \sum_{t=1}^{n} \frac{CF_t}{(1 + IRR)^t} = 0$$

I…….value of planning investment,

CFt……...planning profit from the investment in each period t,

IRR…….. required internal rate of return,

n………...duration of required investment return.

Return, profitability and risks.

Generally, new enterprises are more risky than old ones because they function for a shorter period and investments have to maintain for a longer time. Therefore, investors divide them into more development stages. The younger enterprise, the higher risk and the bigger anticipated investment return. Anticipated year return decreases from 8% in financing establishment and start-up business on app. 30% in case of financing the third stage of enterprise development.

Anticipated investment rates of return together with the enterprise evaluation determine the share value that investor is willing to pay in order to purchase certain share of basic capital. Since venture capital is invested into enterprises with growing potential, investor deserves the information about probable enterprise value when he decides to sell his investments and realise his profit from invested capital.

Investor guesses the value of enterprise to the date of maturity, he discounts it to presence and thus receives a present value of enterprise. Anticipated year’s rates of return can slim up to 80%. Percentage is sometimes too high in order to compensate bad investments.

Average rate of return from venture capital investment is about 15% what means that this branch does not always reach high return of capital. Several financial observers say that obtained returns of capital are not high enough to compensate risk.

The most significant part of venture and developing capital is a risk control. Those investors and financial managers who can evaluate possible risk from planned investments and to set and control the parameters of own investment portfolio in order to minimise risk – to manage a risk – can obtain profit. Those investors and managers who are not capable to do so usually go bankrupt.

Venture and developing investing differs from common types of investment process. The main difference is in the level of risks and profits. Venture and developing capital investors can evaluate this capital better than portfolio investors of the investment companies and funds. On the other hand, risk from loosing part or even whole capital is much bigger in venture or developing capital.

If we ranked the investments from the point of view of risk, venture and developing financing would be at the top of the list, in the area of high risk. At the bottom we would find the least risky tools such as state cash cheques and state obligations. In the middle of this list we would find 'blue chips' obligations, common obligations, shares and junk bonds.

The other reason is generally well-known fact that revenues and risk levels differ from each financial instrument and in every country. Fund managers deal with the quantitative analysis of revenues and risks of venture and developing investments. Accepted rate of return for these managers is 35% as a minimum rate.

Assurance against lost.

Common shares are the riskiest share tool because investments into private enterprise in the form of venture capital do not have required liquidity. There exist no public market where such shares could be traded. The most important is to invest to companies with top business plans that would allow further growth of the company.

Investors can assure themselves by offering capital in several stages. Investor can also create a consortium with another venture capital investors. They can thus manage and lower risk which they face after investing to portfolio of different enterprises.

Finally, investor can decrease risk by purchasing prior shares with specific rights and preferences comparing to owners of common shares. The final investment contract can have a lot of pages but key principles are summarised on several pages about the investment conditions. Part of contract sets considerable requirements on management and employees of the enterprise: issuing of annual reports with auditor report, issuing of monthly or quarterly reports without auditor report, agreements about non-competing, life insurances of key managers and contract about transfer of shares. If the manager priory leaves an enterprise and he owns the shares, he must resell them for their nominal price.

Investors usually write an agreement with enterprise to obtain a right to repurchase shares prior to third persons. Such agreement can restrict options on shares or managers salaries. Despite of the due diligence control system, financial wariness and juristic agreements risk of investing into basic capital cannot be eliminated.

Syndicate as the way to decrease risk of investments.

Should invested capital be too high or too risky, investors can decide to syndicate a project. Under syndication we mean joining of several investors to joint investment in order to obtain required sum. As usual, one investor has decisive share. On one hand, syndication is advantageous for investors because it decreases a risk; on the other hand, it brings also several advantages to entrepreneur:

- it restricts investor to obtain majority of equity shares and significant one-side control over the company,
- it allows to use the experiences of all investors in a favour of enterprise,
- it usually assures higher value of investment than the one from a single investor.

There exist an optimal way of financing for every type of enterprise in practice and theory. Suitable financial tools are given by industrial branch, applied technology, range of inventories and time and value characteristics of enterprise.

3.4.6 Proposals for the venture capital development

Comparing to traditional developed economies, financing of SMEs in Slovakia and Hungary by venture capital is underdeveloped. Such fact could be rather surprising for uninformed market participants. Despite of anticipations and prognoses, development of venture capital financing stagnates because of various causes:

- general lack of relevant managerial experiences of domestic entrepreneurial subjects and entrepreneurs,
- lack of information about the opportunities of venture capital. Venture capital funds must present themselves to entrepreneurs to become well known.
- misunderstanding of investment process in obtaining the venture capital,
- missing or non-transparent legislation in the area of venture capital,

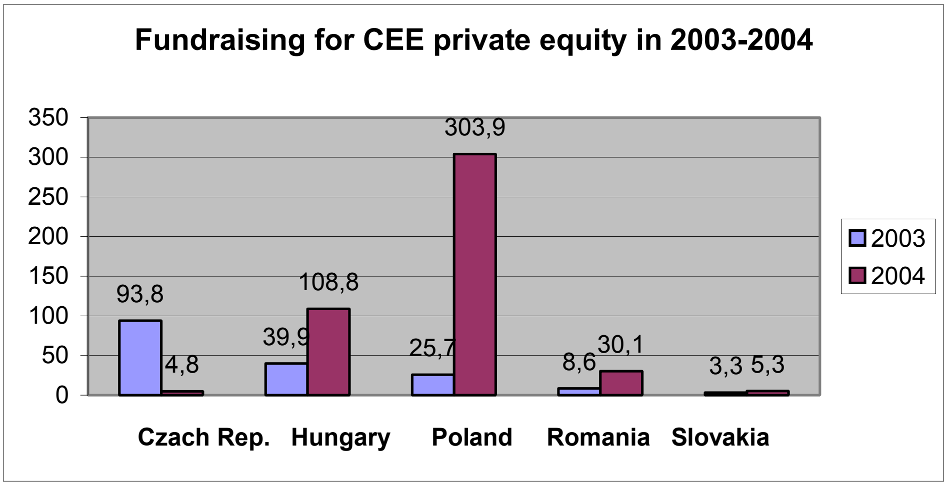
- low direct state support of small and medium-size entrepreneurs,
- tough exit from enterprise.

The position of venture capital does not have to be seen chanceless. All these causes can be minimised by better information, education and state support.

1. To increase knowledge about the venture capital. Since firm managers are not well informed and they do not know this form of investment they can hardly use it in practice. This is a task for funds to inform about the opportunities of venture capital and to present their activities and results. Venture capital funds should focus more on marketing and promotion.
2. It is necessary to explain how financing by venture capital influences the entrepreneurial subjects and how it functions. Firms willing to obtain venture capital must know its advantages and disadvantages.
3. Government and parliament should also focus more on venture capital. Big contribution is in creation of integrated and clear legislation. Clear rules and conditions would be most helpful in venture capital development.
4. Advisory services of state and its organs would contribute to venture capital development as well.
5. Important task is to provide problem free exit from enterprise.

The concrete examples of venture capital growth in Slovakia and Hungary are elaborated in the EVCA research from 2003-2004 where several factors were investigated. First, fundraising for CEE picked up dramatically in 2004. Notably, the vast majority of funding across the CEE region is sourced from non-domestic investors.

Chart 24: Fundraising for CEE private equity in 2003-2004 (in mil. Euro).



Source: [84]

Investment levels increased significantly in 2004 with a total 547 mil. Euros invested across the CEE region. This is an overall increase of 22% compared to 2003. However, the investments trends by country varied. Hungary and Slovakia showed increases in investments by amount, while activity in Poland, the Czech Republic and Romania decreased compared to 2003.

Table 23: Investments as a percentage of GDP in chosen CEE countries in 2003-2004 (in mil. Euros).

Country	2003 Total investments	2004 Total investments	Invest. % of GDP 2003	Invest. % of GDP 2004
Hungary	110 755	121 562	0,154	0,150
Poland	177 213	134 437	0,098	0,069
Slovakia	4 479	7 059	0,016	0,021
Czech Republic	39 422	16 074	0,052	0,019
Total	331 869	279 132	0,320	0,259

Source: [84].

As in 2003, the largest portion of invested capital went into buyout transactions, followed by expansion capital investments and replacement capital. Notably, there were no reported seed stage investments and a significant reduction of start-up capital. It is fair to say that the equity gap seen across Europe is even more visible in the CEE region.

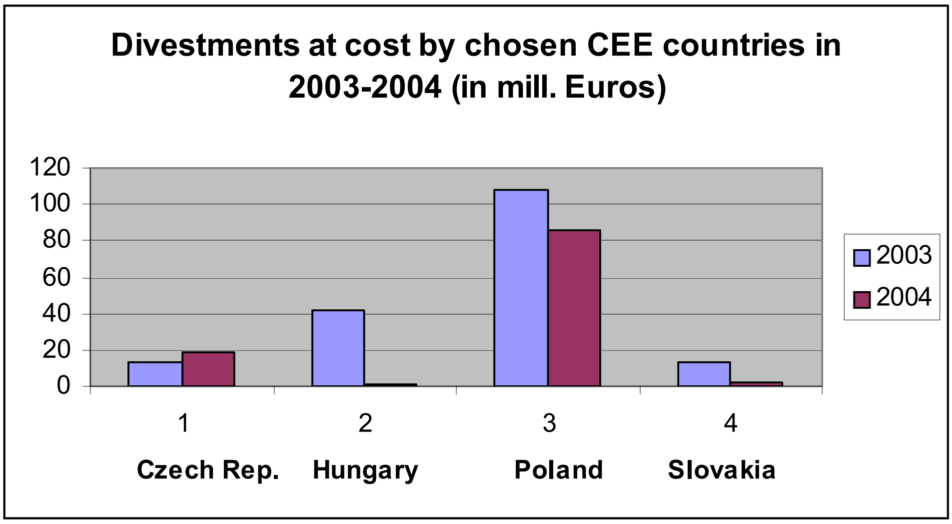
Table 24: Type of investment by chosen CEE countries in 2004.

Capital/Country	Czech Republic	Hungary	Poland	Slovakia
Seed	-	-	-	-
Start-up	2 245	501	-	947
Expansion	13 829	120 561	44 100	6 112
Replacement capital	-	-	59 494	-
Buyout	-	500	30 843	-
Total	16 074	121 562	134 437	7 059

Source: [84].

Measured by investment costs, the level of exit activity decreased significantly in 2004 as compared to 2003. The statistics, however, do not measure the actual proceeds received upon exit and therefore do not fully show trends in terms of capital return to investors. Divestments through trade sales, sale to management, repayment of principal loans and by other means showed the largest decreases year to year. Exit through the public markets and in secondary sales to other venture capitalists in 2004 were similar to 2003 levels and write-offs showed a slight increase.

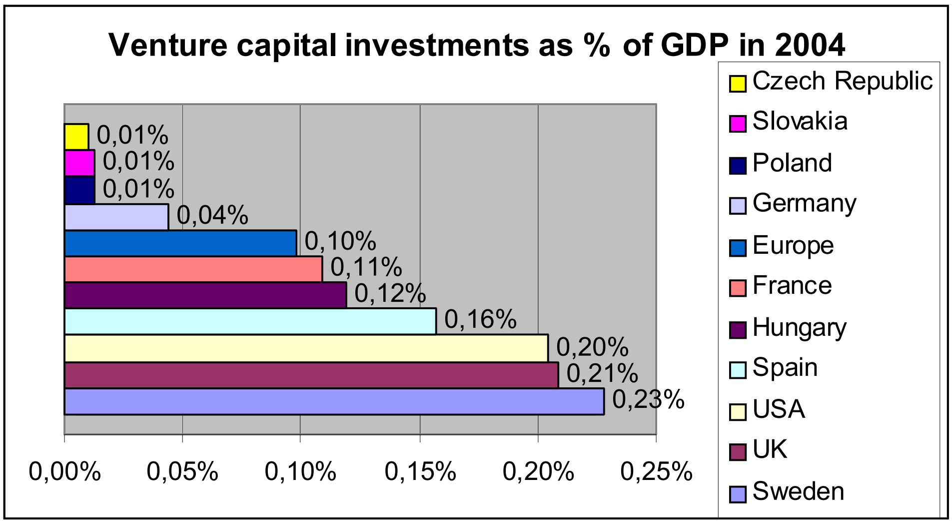
Chart 25: Divestments at cost by chosen CEE countries in 2003-2004 (in mil. Euros).



Source: [84].

As seen from Chart 26, share of venture capital on GDP in developed economies is much higher than in analysed CEE countries. This is caused by several obstacles mentioned above.

Chart 26: Venture capital investments as % of GDP in 2004 in chosen countries.



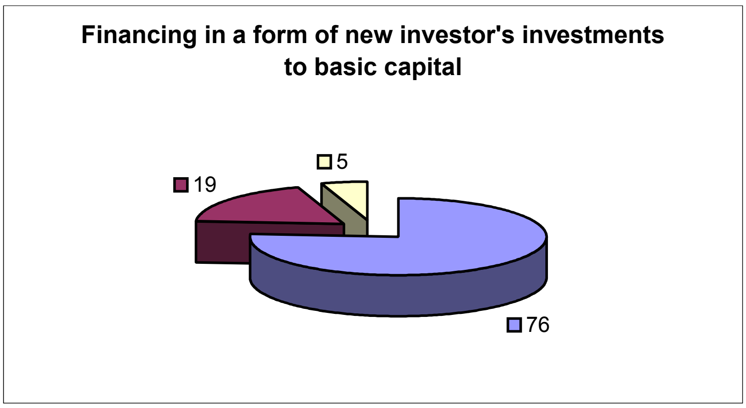
Source: [84].

4 ANALYSIS OF FIRMS APPLYING THE VENTURE CAPITAL

4.1 Research of opinions of entrepreneurs accepting a business partner

One of the opportunities how to provide financing of the entrepreneurial activities is to increase a basic capital by another investor. Research focused on opinions of SMEs how they perceive that another investor obtains a minority share in firm for restricted period of 3 to 5 years. The results show a conservative attitude of Slovak entrepreneurs to mentioned form of financing. More than three quarters of asked businessmen do not want partner in a firm. Only almost one fifth is more open to such non-banking financing and to accept a new partner under certain conditions. This form of financing is fully accepted only by every twentieth research representative.

Chat 27: Acceptance of another minority partner in the firm.



Source: [66].

Legend:

76% - no new investor partner wanted,

19% - acceptance of new investor partner under certain contract conditions,

5% - acceptance of financing by new partner to provide developing project.

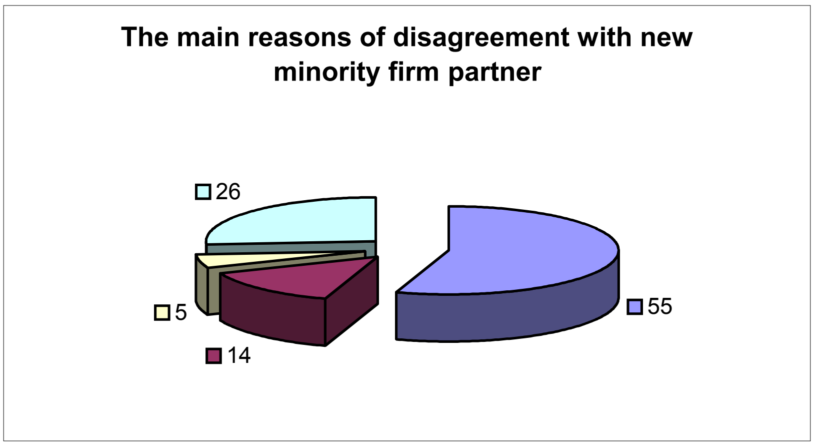
SMEs focusing on agricultural and food production (83%) as well as on transport, post and telecommunications (82%) do not want another investor partner. Concerning the regional division of Slovakia, SMEs from Žilina (83%) and Prešov (82%) region have the same attitude to investor.

Enterprises with year's turnover from 10 mil. to 50 mil. Sk (27%), with number of employees from 10 to 49 (25%) as well as SMEs performing in the industrial production (27%), hotels and restaurants (33%) and in Trenčín region (25%) concerning the regional division, accept this form of financing depending on contract conditions.

Financing of business by investing into basic capital is accepted mostly in firms with year's turnover from 50 mil. to 100 mil. Sk (14%), from 100 mil. to 500 mil. Sk (11%), with 50 to 249 employees (9%), performing in the industrial production (11%) and exporting firms (25%).

Those SME representatives who denied an interest for a new partner in a firm had a chance to specify the reasons why they disagree with given form of financing of the entrepreneurial activities. More than half said they do not want to share decisions in a firm and almost one quarter stated that firm follows the other objectives than profit maximization. The complete answers are shown in Chart 28.

Chart 28: The main reasons of disagreement with new minority firm partner.



Source: [66].

Legend:

55% - I do not want to share decisions,

14% - I do not want to share future economic results,

5% - I am afraid of weakening the position in a firm,

26% - my firm concentrates on another objectives than profit maximization.

Unwillingness to share decisions in firm with another partner was shown mainly in firms with turnover from 1 mil. to 5 mil. Sk (61%), performing in trade (63%) and in those with a seat in Žilina and Košice region (both 69%).

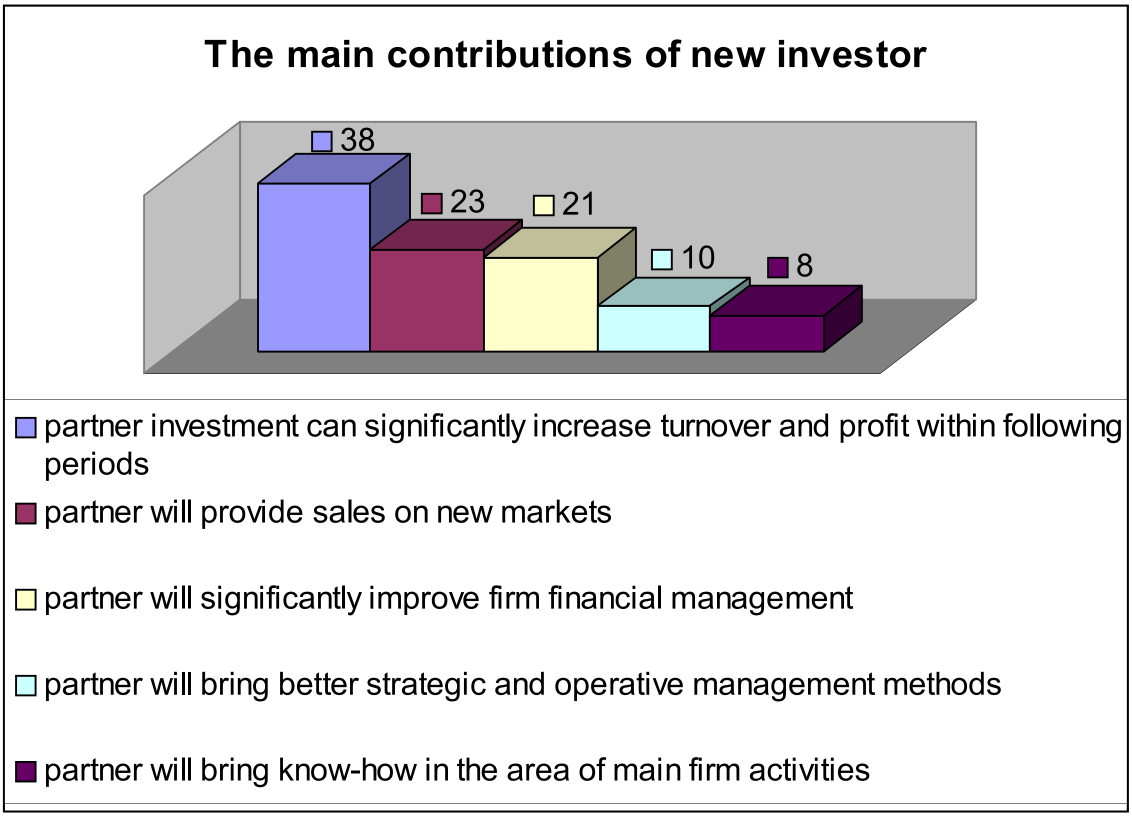
Opinion that firm follows also different objectives than profit maximization is mostly clear in those with turnover from 10 mil. to 50 mil. Sk (42%), from 100 mil. to 500 mil. Sk (60%), performing in the industrial production (39%), transport, post and telecommunication (32%), other entrepreneurial activities (44%), those with a seat in Trnava (31%), Trenčín (37%), Nitra (35%) and Banská Bystrica (33%) regions.

Unwillingness to share future profit was declared in firms with year turnover from 50 mil. to 100 mil. Sk (28%), with 10 to 49 employees (19%), performing in hotels and restaurants (19%), in transport, post and telecommunications (22%), financial services (40%), with a seat in Bratislava and Žilina regions (24% and 19%).

Threats of weakening the position in firm were declared in enterprises with turnover up to 1 mil. Sk, performing in financial sector (both 10%) and with a seat in Prešov region (11%).

Representatives of SMEs declaring willingness to use financing of entrepreneurial activities by accepting a new investor specified the main contribution. Almost two fifths of SME representatives said that they perceive the main contribution of investor in increasing of turnover and profit. Almost one quarter of asked persons are awaiting sales on new markets from new partner and more than one fifth thinks that partner will help them to improve firm financial management.

Chart 29: The main contributions of new investor.



Source: [66].

The first answer that investment of partner would lead to significant growth of firm's turnover and profit declared the representatives of enterprises with turnover from 100 mil. to 500 mil. Sk (50%), performing in the area of hotels and restaurants (56%), transport, post and telecommunications (50%), and with a seat in Nitra (45%) and Prešov (57%) regions.

The main investor contribution - selling on new markets - is perceived in firms with turnover from 5 mil. to 10 mil. Sk (29%), from 10 mil. to 50 mil. Sk (33%), with 10 to 49 and 50 to 249 number of employees (30% and 29%), performing in the industrial production (30%) and constructions (32%), and in those with a seat in Trnava (40%) and Košice (35%) regions.

New investor is expected to improve firm financial management in firms with turnover from 100 mil. to 500 mil. Sk (33%), performing in the industrial production (28%), transport, post and telecommunications (33%), financial services (67%), and with a seat in Žilina and Banská Bystrica regions (40% and 28%).

Venture capital is relatively a new term in financing of SMEs both in Slovakia and Hungary. Such investments face certain level of disbelief, the entrepreneurs are afraid of loosing the control over the company, they do not want to share future economic results (see Charts 27-29). Venture capital is mostly popular and used in developed economies of USA and former EU-15 countries. Venture capital has been invested in Slovakia and Hungary into branches such as industrial production, trade, construction industry, and financial services.

Thesis 4: I confirm the fourth hypothesis and therefore I state that total venture investments grew in Hungary up to over 121 mil EUR and in Slovakia up to 7 mil. EUR, what was 0.15 % of GDP in Hungary and 0.021 % of GDP in Slovakia respectively. Dominant were expansion investments in both countries (99% of all venture investments in Hungary and 87% of all in Slovakia respectively). Although such investments did not notice significant share on total GDP, their growth in analysed periods is of positive trend and will contribute to further development and competitiveness of analysed SME sector. Such shares on total GDP are greater in developed countries as USA or former EU-15 but they notice constant growth in all sectors.

Since 1999, many researches in Hungary and Slovakia dealing with the economic impact of venture capital were elaborated. I compare them and make final judgements. I provide following evidences and statements of hypothesis 4 and thus confirm its assumptions: (1) the revenues after the venture capital entry into enterprises were doubled comparing to those SMEs without such investments, (2) the number of employees usually growths faster and in significant numbers (app. 15% per year), (3) the investments into equipments, buildings and financial tools grew by one half, (4) development of venture capital in enterprises has brought higher revenues in state and municipal budgets from taxes, it has brought new trading and exporting facilities, venture capital growth accelerated the employment, (5) venture capital funds offered the expertise aid in enterprise development.

Companies applying the venture investments have stimulated the economy as whole: (1) They show a fast growth – such investments are rather new in this territory and therefore it is bit difficult to evaluate their whole impact on economy, but they noticed faster growth of turnover than 100 other most meaningful enterprises within analysed region. (2) They invest intensively – they invested almost three quarters of whole turnover by 2004. Research and development costs showed growth in more than 50% of companies. (3) They export – growth of export in venture-financed firms was more than one third and meant almost one quarter of all their revenues since 2000.

Venture capital investors are attractive partners because they offer financial and non-financial aid to SMEs: (1) they offer capital allowing fast growth of SMEs, (2) they offer leadership and experiences, (3) their contribution is evaluated positively.

4.2 Company BALA

Joint-stock company BALA was founded in 1998. Its headquarters is in Holice, 35 km away from Bratislava, where they have own places of office, operation and production at their disposal. They are presented as a medium-sized firm at their market. The work of employees is directed by qualified experts - building engineers and technicians - who are at customers' disposal in order to offer services over the standard. In 2002 firm BALA received the certificate of a quality management system pursuant to the standard STN EN ISO 9002 : 1997, recertification to the standard STN EN ISO 9001 : 2000 was realized in 2003. They also possess a certificate for their products of steel-constructions used for telecommunication purposes.

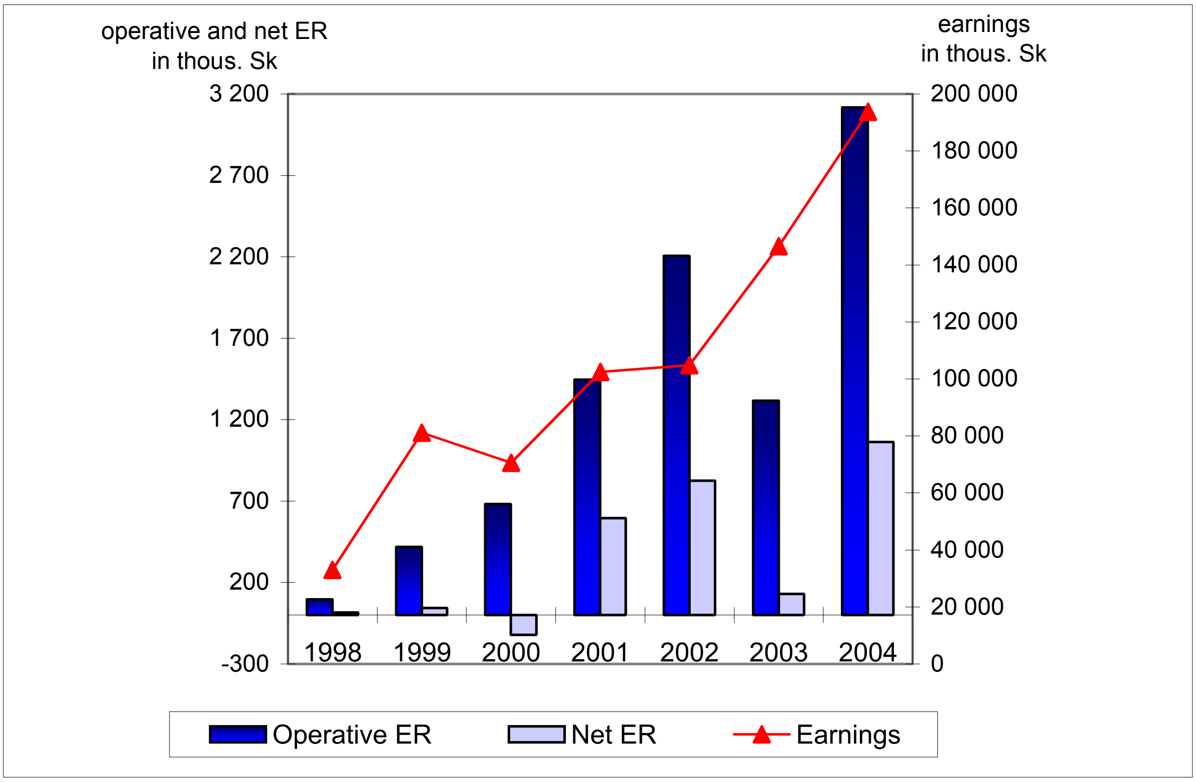
Seed Capital Company entered BALA Company in June 1999. The structure of financing was realised by increasing the basic capital 2 mil. Sk for 23% share in BALA Company and by offering a loan of 1 mil. Sk with 17 % interest p.a. due in 3.5 years. The aim of financing was to purchase raw materials and investment property to spread out the ironworks. Seed Capital Company offered next 5 mil. Sk. in the second round of financing.

BALA Company reached following positive effects after the seed capital entry:

- company specialised the main activities provided,
- company expanded on foreign markets of Hungary, Austria, Switzerland,
- company received Certificates of quality mentioned above,
- company increased the revenues and market share.

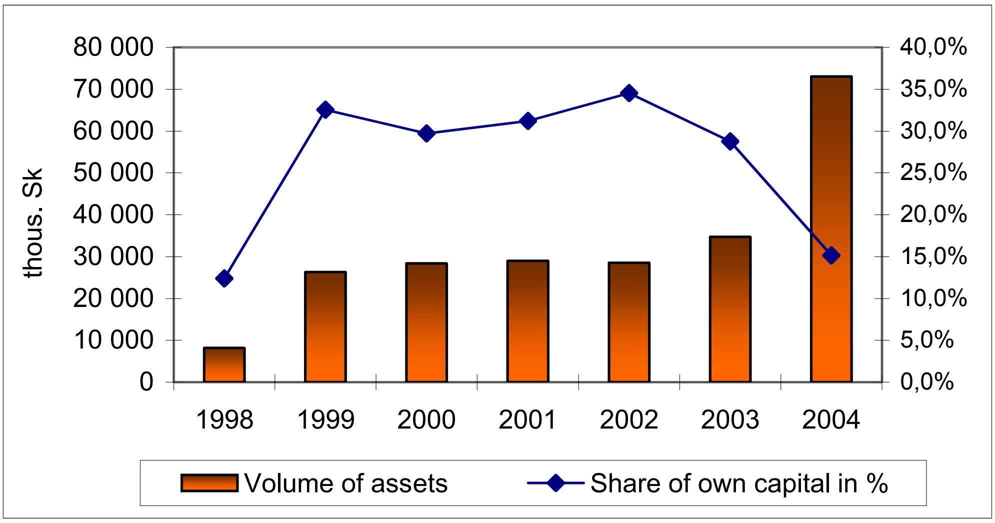
The following charts demonstrate the financial situation in analysed company. AS we see from Chart 30, total earnings increased from 1999 after the venture capital investment by several thousands of Sk (from 1200 thousand up to 3000 thousand in 2004 respectively) and further growth was expected also after the venture capital exit from the company. The venture investment also strengthen the share of own capital up to 35% on total capital since the VC entry in 1999 (Chart 31). Not only the analysed company could improve its position at domestic market and further expansion on foreign markets, it also improved the indicators of financial analysis – ROE and ROA (from 0.4 in 1999 up to over 9% in ROE and almost 2% in ROA in 2004 respectively – see Chart 32).

Chart 30: Reached positive effects of BALA, ltd. – operative ER, net ER, earnings.



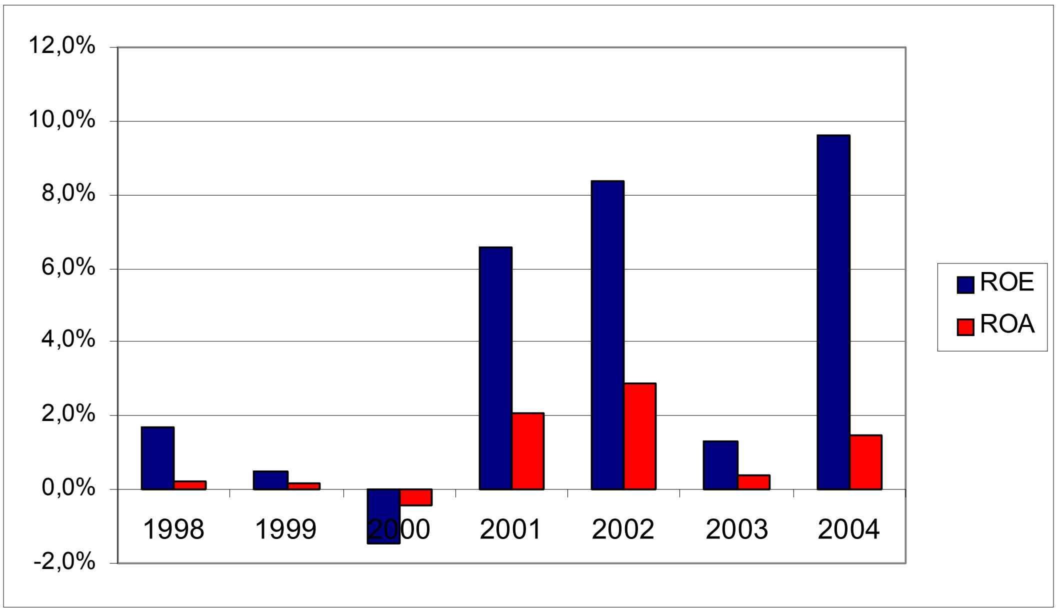
Source: Calculations from [90].

Chart 31: Reached positive effects of BALA, ltd. – volume of assets, share of own capital.



Source: Calculations from [90].

Chart 32: Reached positive effects of BALA, ltd. – ROE, ROA.



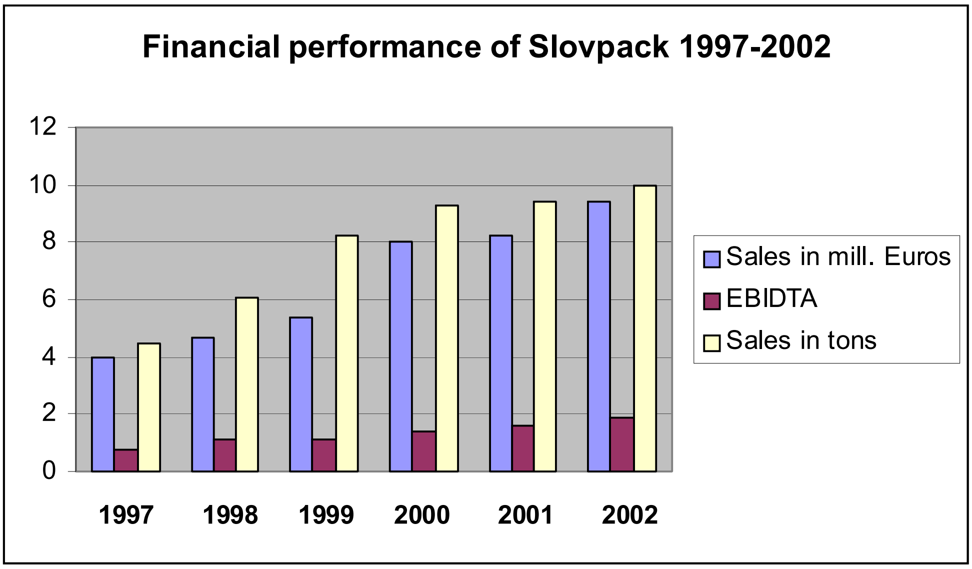
Source: Calculations from [90].

After venture fund – Seed Capital Company reached deserved return of investments, it decided to leave BALA Company with satisfactory position and perspectives for its further development.

4.3 Company SLOVPACK

Slovpack was founded in 1994 as a specialised manufacturer of plastic packaging for clients in the Slovakian food and industrial construction sectors. By 1998, although ranked number three in the local market, the company was under a joint venture ownership structure that handicapped effective decision-making and impeded development. Thus, to Raiffeisen Ost Invest Slovpack was an attractive investment proposition, with a management team that had extensive experience. Slovnaft, a 50% owner of the company, was searching for a reliable joint venture partner to develop Slovpack. Buying out Slovnaft's outgoing joint venture partner for 1.1 mil. Euros, Raiffreisen Ost Invest set about developing a five-year business plan and a new development strategy. The strategy saw the company invest in new moulding machinery and diversify its product offering while at the same time boost product quality. Reiffeisen Ost Invest ensured that production was tied directly to client orders rather than to forecast demand. By 2002, Slovpack's sales had grown from 4 mil. Euros to 10 mil. Euros and productivity increasing by 30% (Chart 33). Slovpack grew to be the leader of the Slovakia market, and since 2002 also an exporting company to Germany, the Netherlands, Austria, the Czech Republic and Poland. In 2002, Raiffreisen Ost Invest exited in a management buyout transaction and realized 3.3 times its invested capital with an IRR of 32%.

Chart 33: Financial performance of Slovpack 1997-2002.



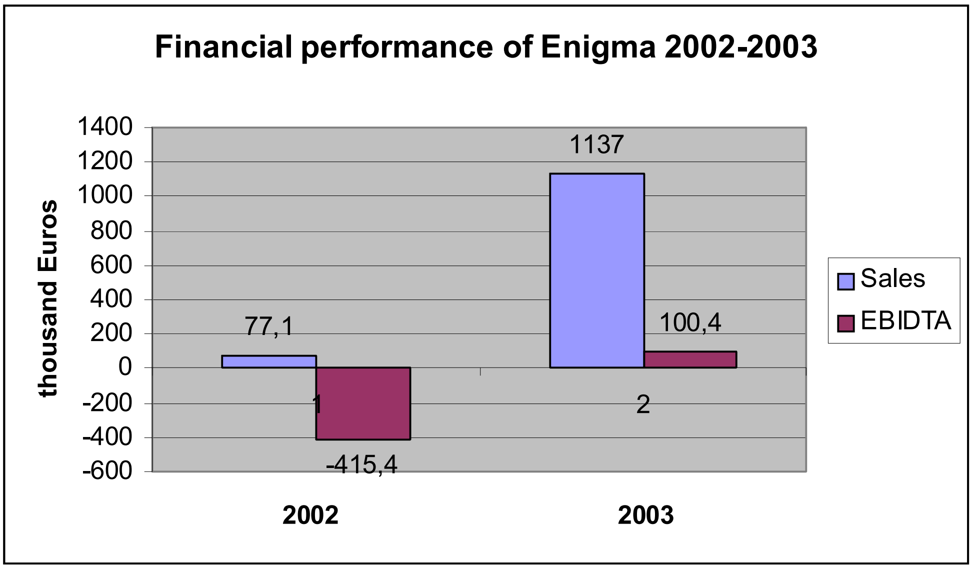
Source: Calculations from [91].

4.4 Company ENIGMA

Enigma developed a working prototype of a secure mobile payment system. With this process successfully completed, funding was needed to bring the system closer to commercialisation. For Euroventures, Enigma's principal attraction lay in its founder's successful track record and potential of a secure payment system targeted at rapidly developing mobile telephony services. The subsequent deal saw Euroventures commit 1 mil. Euros for a 45% stake in the business. Fast Ventures invested 400 000 Euros ten months later, valuing the company at a 40% premium to Euroventures' price. As seen from Chart 34, total sales of analysed Hungarian company increased from 77 thousand Euros to 1137 thousand Euros within only one year. The productivity reached also positive figures.

On exit in 2004, Euroventures achieved a cash multiple of 2.6 times and an IRR of 87%. Fas Euroventures exited at the same time, realizing a 2-times cash multiple and a 70% IRR.

Chart 34: Financial performance of Enigma 2002-2003.



Source: Calculations from [92].

4.5 Company EURONET WORLDWIDE

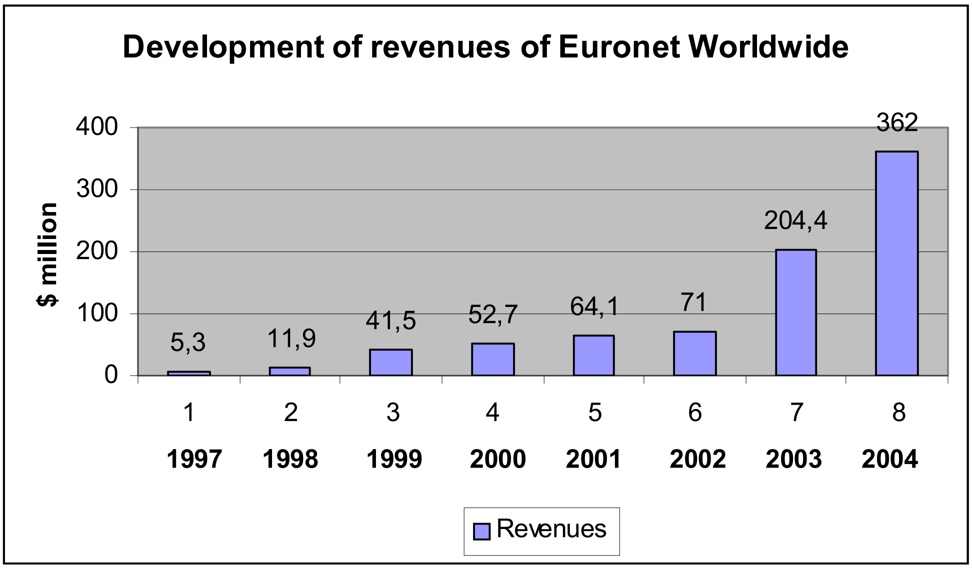
Euronet's progress, from start-up to international leader, initially depended on its ability to expand sales volume aggressively in key regional markets. Euroventures and the Hungarian-American Enterprise Fund (HAEF) each invested 1 mil. USD in 1994. Two years later, Innova Capital and Advent International invested a total of 6.8 mil. USD in the company to expand its offering to the Polish market. On full exit in 2000, Euroventures achieved an IRR of 125% and a total cash multiple of 11.3 times. In partial exits during the 1997 initial public offering and in subsequent public market sales, HAEF, Innova and Advent realized cash multiples of 7.8, 10.3 and 5.2 times on their respective divestments. Innova and HAEF retrain stakes in the company.

Euronet Worldwide, as Europe's first independent automated teller machine operator, knew it had a chance to capitalize on its first-mover advantage to become a dominant regional player, as local economies shifted from cash to plastic-based transactions and the region's consumers began using banking services on a mass scale. Soon, Euronet was exporting to Poland, Germany, Croatia and the Czech Republic.

Euronet revenues grew dramatically during the expansion years. Cash profitability was achieved by late 2002, and EBITDA of 48 mil. USD is forecast on revenues of 362 mil. USD for 2004. Euronet Worldwide is now established as a global industry leader in secure electronic financial transaction solutions. It operates on one of the largest independent pan-

European ATM networks, with more than 162 000 point-of-sale terminals across 68 000 retailers in Europe, Asia, and the USA.

Chart 35: Development of revenues of Euronet Worldwide.



Source: Calculations from [93].

The final chapter focused on attitude of entrepreneurs to use and accept the venture capital investor for financing the enterprise. Research showed rather conservative attitude of representatives what is a typical feature in the transition economies of Hungary and Slovakia. Only SMEs with year's turnover over 50 mil. Sk and located in developed regions showed positive trends in acceptance of minority partner. The main contribution of investor is perceived in increasing the profit and shares (Charts 27-29).

Thesis 5: After analysing four companies, two from Slovakia and two from Hungary that used the venture capital investments in order to improve their financial situation, to spread out their trading activities onto foreign markets and to strengthen their competitive position, I state and confirm the fifth hypothesis that venture capital contributes significantly to increased revenues, better economic performance and indicators of the financial analysis. Although this choice is not representative and it is impossible to make final conclusions on such sample of enterprises, the SMEs were chosen in order to introduce the possibilities of venture investments and to demonstrate the positive influences and impacts of venture capital on SMEs and thus support its usage in practice. It would take more than hundreds of SMEs to analyse in order to provide serious judgements what

would be far from my research field and dissertation capacities. In all analysed SMEs venture capital succeeded in increasing the revenues and sales:

- ***In BALA Company earnings grew by over 150% within 5 years of venture capital investments (1999-2004) and ROE up to 10%, ROA up to almost 2%. This company also expanded on foreign markets.***
- ***SLOVPACK Company increased sales expressed in mill. Euros by almost 150% (from 4 up to almost 10 mil. Euros). VC investment also contributed to the productivity growth (1997-2002).***
- ***ENIGMA Company increased sales from 77 thousand Euros up to 1137 thousand Euros and venture investment contributed to the positive productivity.***
- ***Significant growth of revenues noticed also EURONET WORLDWIDE Company within 8 years of investment fund performances (increases from 11 mil. USD up to 362 mil. USD).***

5 CONCLUSION

The private equity industry in Central and Eastern Europe (CEE) is more than 15 years old. The first fund raisings and investments were completed in 1990. Although relatively young compared to the private equity industries of Western Europe and the USA, CEE private equity has developed considerably since its inception. Estimates suggest that during the past 15 years, more than 7 bn. Euros of funding has been raised for private equity funds dedicated to the CEE countries [29, 35]. From this, over 900 investments have been made in the region and more than 400 exits achieved. It is further estimated that of the funds raised to date, some 75% have been invested.

Over this period, private equity financing rapidly gained acceptance as a permanent part of the CEE region's capital markets. With an increasing number of private equity investments and exits completed, awareness of private equity as a financing source has grown among those needing financing as well as among policymakers and other capital market players. While in the early days of CEE private equity the prominent form of external funding for many companies was bank loans, this is no longer the case following the privatization of banks across the region. Private equity in the CEE region now plays a similarly important and prominent role to that seen in Western Europe. Companies and managers are increasingly looking to private equity and equity in general to fund their start-ups, expansion plans and buyout opportunities.

The main scientific objective of dissertation was to determine usage and impact of venture capital on profitability, growth and position of analysed SMEs. The most important analysis of private equity and venture capital in order to fulfil such objective was provided in chapters 3.4 and 4.2 - 4.5 where risk investment fundraising was introduced as first, its main requirements, market participants with financial flows, conditions of venture market functioning, impacts of private equity and venture capital on SMEs and finally, in latter chapters, the concrete SMEs, which used silent partner in a form of venture investment were analysed. Results of these analyses are provided not only in mentioned dissertation chapters but also they are part of thesis 4 and 5. Total venture investments grew in Hungary up to over 121 mil EUR and in Slovakia up to 7 mil. EUR, what was 0.15 % of GDP in Hungary and 0.021 % of GDP in Slovakia respectively. Dominant were expansion investments in both countries (99% of all venture investments in Hungary and 87% of all in Slovakia respectively). Although such investments did not notice significant share on total GDP, their growth in analysed period is of positive trend and will contribute to further development and competitiveness of analysed SME sector.

In order to confirm the fourth hypothesis I compared several researches from which we see that the revenues after the venture capital entry into enterprises were doubled comparing to those SMEs without such investments; the number of employees usually grew faster and in significant numbers (app. 15% per year); the investments into equipments, buildings and financial tools grew by one half; development of venture capital in enterprises has brought higher revenues in state and municipal budgets from taxes, it has brought new trading and exporting facilities, venture capital growth accelerated the employment; venture capital funds offered the expertise aid in enterprise development. My conclusion was that I confirmed the Hypothesis 4 so that venture capital played a key role in further SME development and positively influenced their successful performance at both domestic and foreign markets.

Companies applying the venture investments have stimulated the economy as whole: they show a fast growth – such investments are rather new in this territory and therefore it is bit difficult to evaluate their whole impact on economy, but they noticed faster growth of turnover than 100 other most meaningful enterprises within analysed region. They invest intensively – they invested almost three quarters of whole turnover by 2004. Research and development costs showed growth in more than 50% of companies. They export – growth of export in venture-financed firms was more than one third and meant almost one quarter of all their revenues since 2000.

In order to evaluate the impact of venture capital on analysed firms, I used financial analysis qualitative methods and thus I calculated ROA, ROE, EBIDTA, total earning, total sales, total revenues and productivity growth of chosen firms. The SMEs were chosen in order to introduce the possibilities of venture investments and to demonstrate the positive influences and impacts of venture capital on SMEs and thus support its usage in practice. I obtained following statements and conclusions:

- In BALA Company earnings grew by over 150% within 5 years of venture capital investments (1999-2004) and ROE up to 10%, ROA up to almost 2%. This company also expanded on foreign markets.
- SLOVPACK Company increased sales expressed in mill. Euros by almost 150% (from 4 up to almost 10 mil. Euros). VC investment also contributed to the productivity growth (1997-2002).
- ENIGMA Company increased sales from 77 thousand Euros up to 1137 thousand Euros and venture investment contributed to the positive productivity.

- Significant growth of revenues noticed also EURONET WORLDWIDE Company within 8 years of investment fund performances (increases from 11 mil. USD up to 362 mil. USD).

In order to fulfil and complete the main scientific objectives, partial objectives were set up. They were constantly fulfilled by studying domestic and foreign literature sources and by collecting required data from secondary already provided researches. The main idea of 'the first' partial objectives was:

- to compare the transition from planned to market economy in Hungary and Slovakia;
- to analyse and determine how transition processes affected the SMEs and whole entrepreneurial environment in both countries at micro and macro level,
- to determine what was the main driving force in SME creation,
- to introduce and than evaluate the SME sector, its main characteristics, definitions, and trading activities in both countries.

Results of the 'first group' of partial objectives were elaborated and summarised in Thesis 1 and 2. My conclusion is that not the inflow of direct foreign investments but the structural transformation that included privatisation of big state enterprises, taking away property from the state and creating of new class of capitalists and entrepreneurs were one of such elements in SME creation. What is more, in former Czechoslovakia decided not only for a direct privatisation of state enterprises like in Hungary but also for a coupon privatisation and thus they allowed all citizens to participate on shares and created value. The main objectives to launch privatisation and thus to make a potential for the entrepreneurs' creation were: (1) to change the mechanism of funds allocation in the economy, (2) to support the stimulation at micro level, (3) to force the enterprises to react on demand and consumer behaviour instead of fulfilling the central plans, (4) to lower state budget deficits and bring new taxation revenues, (5) to liberate production and entrepreneurial potential in order to satisfy the ever changing need of consumers for brand new products, (6) to make the economic re-structuralisation easier, and (7) to allow people to make profit. Privatisation has become the main driving force for latter foreign direct investments. Concerning the legislative changes that affected and made creation of SME easier, I include: bankruptcy law, price liberalisation, reform of financial and banking system consisting of central and commercial banks, taxation and accounting reforms, liberalisation of whole market, etc. Privatisation of state property became the main driving force in SME creation in both countries. I measured the economic development by obvious and standard economic indicators: by GDP growth, and latter also by rate of inflation, growing employment, or decreasing level of unemployment. As seen from presented facts and figures in charts and tables from both Hungary and Slovakia, I conclude that SMEs maintain a strong and significant entrepreneurial sector and that these enterprises have vast and vital impacts on whole employment and increasing living standard of citizens. Therefore, I confirm my hypothesis that SMEs did contribute to the growth of both economies during the analysed period and they are expected to maintain their position within the economic significance. Not only SMEs influence the state of the economy, there are certainly also many other causes that contribute to either growth or decline of the economy. My conclusions are: Real GDP grew in both countries, although its growth in Slovakia was much stronger (6-9% per year) than in Hungary (4-6% per year). Technology transfer together with direct investments in SMEs contributed to the growth of the labour productivity which was bigger in Hungary than in Slovakia (60-70% comparing to 55-65% per person employed of the EU-25). As supposed in Hypothesis 2, the SMEs with their positive performance (increased revenues, growing number of SMEs, growing employment in SME sector) contributed also to price stability, since the inflation rate decreased in Slovakia from 13-15% in 1994 and 1995 to 6-7% in 1999 and 2-3% in 2006, and in Hungary from 18-22% in 1992-1996 to 10% in 1999 and 2-5% by 2006 respectively. Significant is also an impact of SMEs on employment growth. As seen from Table 6 and 7 and Charts 6, 7, and 9, the number of SMEs both enterprises of all legal forms as well as natural persons increased (in Hungary up to 1.2 mil. in Slovakia up to 500 thousand by 2006 respectively) and thus increased the employment rate. The share on employment of natural persons has grown up to 30%, medium enterprises 20%, small enterprises 14%, micro enterprises 7%, the rest belongs to big enterprises. Share of SMEs on gross production and total export was changing slightly, with increased volumes since 2003.

The 'second group' of partial objectives include those that aimed to analyse the financial sources of SMEs in both countries, excluding venture capital and private equity as borrowed financial source because it is a unique chapter and was elaborated separately from other borrowed sources and this form of capital was analysed in more details in order to fulfil the main dissertation objective. The idea of 'second group' of partial objectives was:

- to draw a comprehensive financial sources' analysis,
- to compare capital opportunities for SMEs in both countries,

- to show, what kind of capital from own and from borrowed sources is the most important for SMEs or is, at least, perceived to be the most important.

Results of the 'second group' of partial objectives were elaborated and summarised in Thesis 3. Resulting from provided facts in Tables 14-16 and Chart 23 I confirmed the Hypothesis 3, because bank loans were dominating the foreign capital as they grew in Hungary from 1844 mil. EUR in 1999 up to 10490.8 mil. EUR by half of 2005 and in Slovakia with rather similar situation with significant growth of provided loans. Leasing was mainly used by micro enterprises so it did not show significant position within the borrowed financial sources of all SMEs. We see that second biggest growth noticed use of EU funds in both Hungary and Slovakia. The growth of provided bank loans can be interpreted by improved attitude of banks to SMEs, improved market environment with legislation compatible with the EU, creation of several guarantee banks such as SGDB in Slovakia and Credit Guarantee Ltd. and Agrarian Enterprise Credit Guarantee Foundation in Hungary which aimed to guarantee a certain sum of loans and thus made lending more eligible and trustworthy for SMEs. Profit is the most important financial source from own capital, since depreciations are only such sources that lower taxation base as far as they are included in costs and deposits of partners usually occur when SME is based. So deposits are occasional revenue while profit is long-term revenue what means continual growth and development of enterprise. The advantage of financing from profit is that it increases own capital base. Finally, enterprise thus decreases a need for foreign financial sources. The independence of entrepreneurial subject is another advantage and high coverage by own capital simplifies obtaining new foreign sources. I recommend to SMEs to focus rather on untraditional ways and sources of borrowed capital that are not so expensive like banking loans. Such new up-to-date forms of borrowed capital is private equity and venture capital investment, which on one hand means loosing of part own shares on firm assets and entry of foreign partner but, on the other hand, allows to use cheaper capital without any duties to pay interests or extra fees.

Taking into account all partial results from all provided partial researches, I investigated the nature of venture capital and private equity and its significance for and impact on the entrepreneurs in transitive economies of Hungary and Slovakia. Therefore, the 'third group' of partial objectives had to be elaborated in order to maintain a continual switch to the main task of dissertation described in text above. The idea of final 'third group' of partial objectives was:

- to gain the most of characteristics of venture capital as modern and important financial source for SMEs,

- to indicate problems of entrepreneurs before they decide to use venture capital in order to explain the reasons why they choose such capital,
- to explain the role and impact of venture capital on performance and economic results of chosen SMEs,

Results of the ‘third group’ of partial objectives were elaborated and summarised in Thesis 4 and 5, together with recommendations for the entrepreneurs on a basis of provided analysis in chosen firms. Such statements are already provided in text above.

Since the information obtained in former chapters from provided researches and financial analyses of the economic indicators of chosen SMEs are analysed I conclude that the conditions for private equity in CEE continue to develop in a positive way. Many former start-up companies have developed over the years to become more mature market players that continue to grow, in some cases internationally, and provide an ample pool of investment opportunities. Management teams have become significantly more experienced and repeat entrepreneurs are present on the market. The availability of experienced local managers has improved dramatically and is contributing to the growth of management buy-in and management buy-out transactions across the region. Managers with strong and tested track records are now behind new ventures. The region’s companies are increasingly technologically advanced and have proved they can succeed against the best world-class competitors. Debt financing for private equity transactions is also increasingly available, contributing to a growth in the volume of larger deals and widening the scope of transactions being completed. Finally, industry investors, both foreign and domestic, have shown a keen interest in buying CEE companies that received private equity support.

Both the run-up to accession the European Union and the post-accession integration periods are proving to have many positive benefits for the private equity industry in CEE. First and foremost, institutional investors are adjusting their perception of risk in the CEE markets in line with the reality that these are low risk and high growth markets. The harmonization of legal, regulatory, administrative and economic policies with those of the wider European Union has already improved the infrastructure for private equity investments and exits in the CEE region. The economies of the CEE countries are growing at a significantly higher pace than the EU as whole and they continue to receive significant new foreign and inward investment. This indicates that investment opportunities will continue to abound and value creation will flourish.

With continued institutional reforms across the region as well as growing individual wealth creation, local pools of professionally managed capital are increasingly available and will play a growing role in providing capital for private equity exits. While at present these domestic investors do not participate sufficiently as funding sources for CEE private equity, it is mainly due to current legal and regulatory restrictions that should be increasingly lifted during the post-accession integration period.

The development of private equity in CEE is, however, still at a relatively early stage. While the initial activity of a few pioneers commenced in the early 1990s, the bulk of fund raisings and investments did not start until the mid and late 1990s.

Historically, institutional investors from Western Europe and North America have been the main sources of capital for CEE private equity funds. Domestic funding sources have not contributed much so far to CEE private equity funds, whereas in Europe as a whole an average of 50% of capital has been sourced domestically in recent years. It is hoped that this will change in the next few years as continuing pension reforms across the region create increasingly well-capitalised local institutions.

As in Europe as a whole, the largest volume of investments in CEE is in buyout, expansion and replacement capital transactions. It is clear that expansion capital transactions make up a more significant part of the CEE market than in Europe as a whole. This is due in part to the high growth of the CEE economies, where companies are seeking development financing. As well, the number and size of these transactions is on the rise. In terms of sectors, those attracting the most investment capital over the past 15 years include telecommunications, consumer goods and services, industrial products and services, media, and financial services. A wide range of sub-sectors have benefited from private equity financing over the past decade, as can be seen on a sample of companies in the third chapter. Technology has received significant investment capital.

As the major contributors to private equity and venture capital fundraising, institutional investors, such as pension funds and insurance companies, are entitled to the best tax and legal environment possible, not only to improve the efficiency of current investment flows but also because their long-term investment perspective is in line with the long-term business model of the private equity and venture capital industry. They should be entitled to invest freely in private equity and venture capital and geographical limitations should not prevent investing abroad across the European borders.

Given the specifics of the private equity and venture capital business model, which is mainly active through long-term commitments in private companies, investment funds need to be flexibly managed according to the different phases of the private equity and venture capital investment cycle. Investment fund structures should be appropriate to the needs of domestic and non-domestic investors.

Stated scientific dissertation objective and all partial objectives were completely fulfilled. Specified methods were chosen and applied in order to satisfactory end up dissertation tasks. I summarize own contributions to theory and practice as follows:

- I clarified that venture capital and private equity are new forms of borrowed capital in conditions of transitive economies of Slovakia and Hungary and therefore they cause certain disbelief of entrepreneurs to accept a foreign partner who would share management decisions and profit (Chapter 4.1, Charts 27-28),
- I confirmed that firms which used and applied the venture capital either in a form of start-up business or in a form of recovery or large-stage-development capital (or in any of the other forms) successfully continued in their trading activities and developed their firm on key market players and even spread out their businesses onto foreign markets (Chapters 4.2-4.5, Charts 30-35 with the empirical results),
- On a basis of financial analysis methods I calculated several financial indicators (Chapters 2.2.3 and 4.2-4.5) and thus confirmed that firms that used venture capital increased their revenues by over 150%, productivity up to 10%, total sales by almost 200%, they expanded onto foreign markets, increased the production portfolio and made the production more qualified, they improved the management, etc. (Chapters 4.2-4.5, Charts 30-35, Thesis 5),
- I recognised that Slovak and Hungarian SMEs are mostly dependent and financed from own profit out of all own financial sources and profit has become a long-term and unique financial source in order to maintain continuum business (Chapter 3.2, Thesis 3),
- I recognised that bank loans and micro credit programmes are most frequently used borrowed capital of the Slovak and Hungarian SMEs (Chapter 3.3, Charts 20-23, Table 5, Thesis 3),
- I showed on a basis of several provided researches (list of literature and Thesis 3) that ability and willingness to obtain financial sources from foreign partner (such as private equity and venture capital) who would share decisions, profit, sales or who would influence the SMEs in everyday activities is not accepted in huge and significant numbers from several reasons mentioned in text above (Chapters 3.4 and 4.1, Charts 24-29, Thesis 3 and 4),

- I showed that although venture investments are developing in USA and in EU countries in various industry branches and services, the Slovak and Hungarian SMEs are rather unaware to implement them and reach the advantages from accepting such partner (Chapter 3.4),
- I found out on a basis of the economic indicators of the macroeconomic development of Hungary and Slovakia that these countries are still in transition from planned economy to market economy and must improve their entrepreneurial environment by further legislative changes compatible with the EU directives in order to simplify SME expansion and trading (Chapters 2.3-2.4, Thesis 1),
- On a basis of collected and summarised data and information I confirmed hypothesis that mainly privatisation of state property and following legislation changes led to the growth of private sector in both countries and thus contributed to the development of SME sector as we know it nowadays (Chapter 2.3-2.4, Tables 1-4, Thesis 2).

6 LIST OF TABLES

7 LIST OF CHARTS

8 LIST OF SCHEMES

9 LITERATURE

[1] Admati, A.R., Pfleiderer, P.: Robust Financial Contracting and the Role of Venture Capitalists. Journal of Finance, vol. 49, p. 374-402, 1994.

[2] Apolen, P.: Leasing Business Grew Significantly Last Year in Slovakia In. TREND Top in Finances 2001, p. 60 – 61, 2001.

[3] Apolen, P.: Leasing Market Grew Significantly Last Year. In. TREND, No. 11, p. 6B, 2002.

[4] Bagley, Constance E & Dauchy, Craig E. The Entrepreneur's Guide to Business Law (2nd Edition). Thompson South-Western West, 2003.

[5] Bajus, R., Gál, M.: Opportunities for the Development of Small and Medium Enterprises in Region of Stará Ľubovňa. Yearbook from the international scientific conference "Entrepreneurial environment and Ethics on business." Bratislava (Slovakia) 2006.

[6] Bajus, R., Gál, M., Tušan, R.: Influence of Cost Management on Enterprise Effectiveness. International scientific conference "Trends within the systems of enterprise management". Herľany (Slovakia), 2001.

[7] Berger, A.N., Udell, G.F.: The Economics of Small Business Finance: the Roles of Private Equity and Debt Markets in the Financial Growth Cycle. Journal of Banking and Finance, Vol. 22, p. 613-673. 1998.

[8] Blanchard, O. The Economics of Post–Communist Transition, Oxford: Clarendon Press, 1997.

[9] Botosan, C.A.: Disclosure Level and the Cost of Equity Capital. Accounting Review, Vol. 72, No. 3, p. 323-349, 1997.

[10] Bratton, W.: Venture Capital on the Downside: Preferred Stock and Corporate Control. Michigan Law Review. Volume 100, issue 5. March 2002.

[11] Campbell, Katharine. Smarter Ventures: A Survivor's Guide to Venture Capital through the New Cycle. Prentice Hall, 2003.

[12] Carlin, Wendy, John Van Reenen, and Toby Wolfe: Enterprise Restructuring in Early Transition: the case study evidence from Central and Eastern Europe. Economics of Transition, Vol. 3, p. 427-458, 1995

[13] Casson, M.: Entrepreneurship and the Theory of the Firm. Journal of Economic Behaviour & Organization, 58 (2), p. 327-348, 2005.

[14] Claessens, Stijn, Simeon Djankov and Gerhard Pohl.: Determinants of Performance of Manufacturing Firms in Seven European Transition Economies, World Bank, mimeo, 1997.

[15] Csaba L.: The New Political Economy of Emerging Europe. Budapest 2005.
[16] Dvořák, I. – Procházka, P.: Venture and Developing Capital. Prague, Management Press 1998.
[17] Eng, L.L., Mak, Y.T.: Corporate Governance and Voluntary Disclosure. Journal of Accounting and Public Policy, Vol. 22, p. 325-345, 2003.
[18] Estrin, S., Gleb, A., Singh, A.: Shocks and Adjustment by Firms in Transition: A Comparative Study. Journal of Comparative Economics, Vol. 21, p.131-151, 1995.
[19] Estrin, S., Takla, L..: Enterprise Adjustment in Transition: Does History Matter? London Business School, mimeo, 1995.
[20] Fetisovová E.: Financing of Small and Medium Enterprises. Bratislava, Ekonóm 1998.
[21] Fotr J.: Business Plan and Investment Decisions. Prague, Grada Publishing 1999.
[22] Gál, M.: Analysis of Chosen Firms Using the Venture Capital. Yearbook from the scientific conference "National and Regional Economy IV". Herľany, 2006.
[23] Gál, M., Jakubíková, E., Suhányiová, A.: Small and Medium Enterprises in the Region of Košice. In: E + M (Economics and Management). Volume VIII. No. 1, p. 61-67, ISSN 1212-3609, 2005.
[24] Gál, M.: Small and Medium Enterprises in the Region of Košice. Gazdaságtudományi Kozlemények, Volume 3, No. 1, p. 29-43, 2004.
[25] Gál, M.: SMEs in Slovakia – Their Role and Position. Doktoranduszok Fóruma, Miskolc 2002.
[26] Gál, M.: Globalisation – its Trends, Challenges and Impact on Slovak Trade. 4th International Conference of PhD Students. Miskolc (Maďarsko), p. 59-64, 2003.
[27] Gladstone, D., Gladstone, L. Venture Capital Handbook: an entrepreneur's guide to raising venture capital. Prentice Hall, 2002.
[28] Gompers, P.A., Lerner, J.: The Venture Capital Revolution. Journal of Economic Perspectives, Vol. 15, No. 2, p. 145-168, 2001.
[29] Hashi, I., Emadi-Moghamad, M.: Enterprise Behaviour in Transitional Economies. Political Economics, Vol. 41, No. 6, p. 766-778, 1993.
[30] Hellman, T., Puri, M.: Venture Capital and the Profesionalization of Start-up Firms: empirical evidence. Journal of Finance, Vol. 57, p. 169-197, 2002.
[31] Chodásová, A. – Bujnová, D.: Business in Small and Medium Enterprises. Bratislava, Ekonóm 1998.
[32] Jackson, M.: Constrains on Systemic Transformation and Their Policy Implications. Oxford Review of Economic Policy, Volume 7, No. 4, p. 16-25, 1999.

[33] Kocan, B., Klusák, M., Riegel, K., Weig, P.: Societal Subject in Transformation Process – Assumptions and Risks of its Development. Prague, ÚÚNV, 1992.

[34] Kolodko, G.W.: Stabilisation, Recession and Growth in Post socialistic Economy. Warsaw, Institute of Finance, 1992.

[35] Konings, J.: Firm Growth and Ownership in Transition Countries. Economic Letters, No. 55, p. 413–418, 1997.

[36] Kornai, J.: The Road to a Free Economy. Shifting from a Socialist System: The Example of Hungary. New York, 1990.

[37] Kornai, J.: The Principles of Privatisation in Eastern Europe, De Economist, No. 140(2), p. 153–176, 1992.

[38] Kornai, J.: The Great Transformation of Central Eastern Europe: Success and Disappointment. (Article on http://post.economics.harvard.edu), 2005.

[39] Kornai, J.: What the Change of System Reform Socialism to Capitalism Does and Does not Mean. Journal of Economic Perspective. Vol. 14, No. 1, p. 27-42, 2000.

[40] Kornai, J.: Journey to Free Economics. Prague, Academica, 1990.

[41] Kornai, J.: Transformation Recession – A General Phenomenon Examined through the Example of Hungary's Development. Political Economic, Vol. 42, No. 5, p. 579-591, 1994.

[42] Kortum, S., Lerner, J.: Assessing the Contribution of Venture Capital to Innovation. Journal of Economics, Vol. 31, No. 4, p. 674-692, 2000.

[43] Kramer, B., Patrick, M.: Recent Developments in Venture Capital Terms, The Fenwick & West Survey. Venture Capital Review. Issue 12, 2003.

[44] Landesmann, M.: Policy and Transition in East-Central Europe. Vienna, WIIW, 1993.

[45] Lavigne, M.: The Economics of Transition. London, United Kingdom, 1999.

[46] Lizal, L., Singer, M., Svejnar, J.: Enterprise Restructuring and Performance in the Transition. WDI Working Paper 13, University of Michigan Business School. 1996.

[47] Manigart, S., Baeyens, K., Van Hyfte, W.: The Survival of Venture Capital Backed Companies. Venture capital, Vol. 4, No. 2, p. 103-124, 2002.

[48] Marušin, J.: Taxation Aspects of Leasing. Ekonóm 2002.

[49] Mc Kinsey: Global Investor Opinion Survey, 2002.

[50] Mertlík, P.: Deformation of Price in the Czechoslovak Economy. Political Economics, Vol. 41, No. 1, p. 35-46, 1993.

[51] Roland, G.: Politics, Markets and Firms. Transition and Economics, Forthcoming. MIT Press, Cambridge, United Kingdom, 2000.

[52] Romain, A., van Pottelsberghe, B.: The Economic Impact of Venture Capital. Deutsche Bundesbank, Series 1, No. 18, 2004.

[53] Shafik, N.: Making a Market: Mass Privatisation in the Czech and Slovak Republics. World Development, No. 23, p.1143-1156. 1995.

[54] Shikhir, S.: Structuring Venture Capital Deals. Cass Business School, 2006.

[55] Stiglitz, J.: Whither Reform? Annual Bank Conference on Development Economics. USA 1999.

[56] Strážovská E. – Strážovská Ľ.: Small and Medium Enterprises. Ekonóm 1999.

[57] Suhányiová, A., Gál, M.: Tax and Accounting Aspects of Finance Lease by Lessee. Research Reports from the Universities of Košice "Transactions of the Universities of Košice". No. 3-4, p. 38-44, ISSN 1335-2334, 2004.

[58] Šulc, Z.: Some theoretical Questions of the Transformation. Political Economics, Vol. 41, No. 3, p. 319-332, 1993.

[59] Ueda, M., Hirukawa, M.: Venture Capital and Productivity. University of Wisconsin, USA, 2003.

[60] Urban, L.: Structural Aspects of the Transformation Process. Political Economics, Vol. 42, No. 6, p. 723-732, 1994.

[61] Vojtovič, S., Gál, M.: Small and Medium Enterprises in the Conditions of European Integration. Yearbook from the international scientific conference "European Integration: Local and Global Consequences". Brno, Czech Republic. ISBN 80-7157-826-6, 2004.

[62] Vravec, J. – Gál, M. – Sabol, T.: Impact of EU Enlargement on Business Environment of Small and Medium-Sized Enterprises in Slovakia. Club of Economics in Miskolc. Theory, Methodology, Practice. University of Miskolc, Faculty of Economics. Volume 3, No. 1, p. 75-80. ISSN: 1589-3413, 2005.

[63] Wilmerding, A.: Deal Terms, The finer Points of Venture Capital Deal Structures, Valuations, Term Sheets, Stock Options, and Getting Deals Done. Aspatore Inc., 2003.

[64] Wright, M., Robbie, K.: Venture Capital and Private Equity: a review and synthesis. Journal of Business Finance and Accounting, Vol. 25, No. 5-6, p. 521-571, 1998.

[65] Záborský, J.: Venture Capital Funds. TREND, No. 21, p. 5C, 2001.

[66] **www.nadsme.sk**: National Agency for the SME Development. "SMEs Innovative Capacity", 2004.

[67] **www.nadsme.sk**: National Agency for the SME Development. "Business environment - SMEs White Book 2004.

[68] **www.nadsme.sk**: National Agency for the SME Development. "Support of the SMEs in Slovakia", 2004.

[69] **www.nadsme.sk**: National Agency for the SME Development. "State of small and medium enterprises in 2005."

[70] **www.mesa10.sk**: Non-profit agency. "SMEs in the Context of Public Administration Decentralisation", 2004.

[71] http://www.cac-leasing.sk: Universal leasing company. "Volume of leasing businesses in Slovakia and development on Slovak leasing market", 2003.

[72] http://www.seedcapital.sk: Venture capital fund. "Conditions for offering the Micro loans". "Venture capital funds' investments".

[73] http://www.sopk.sk: Slovak Chamber of Commerce and Industry. "Business opportunities in Slovakia by category, date, country, type."

[74] http://www.szk.sk: Slovak Chamber of Entrepreneurs.

[75] www.hnonline.sk

[76] www.eiu.com: The world leader in global business intelligence. "Analysis and forecast of the Slovak and Hungarian Economy".

[77] www.untcad.org

[78] www.government.gov.sk: Web page of the Slovak Government.

[79] www.transparency.cz: Transparency International. "Perception of corruption in the Middle and East European Countries. "

[80] www.statistics.sk: Statistical Office of the Slovak Republic.

[81] www.mnb.hu: National Bank of Hungary.

[82] www.nbs.sk: National bank of Slovakia.

[83] www.szrb.sk: Slovak Development and Guarantee Bank. "

[84] www.evca.sk: Representing the European Private Equity and Venture Capital Industry. 2001

[85] www.evca.sk: Economic and Social Impact of Private Equity and Venture Capital.

[86] en.wikipedia.org: The free encyclopedia of economic terms.

[87] http://en.gkm.gov.hu/data/488337/hu_sme.pdf: Web site of the Hungarian Government: Development of Hungarian SME Financing Programmes

[88] http://en.gkm.gov.hu/data/407997/state_of_sme.pdf: Web site of the Hungarian Government: State of Small and Medium-Sized Enterprises in Hungary 2003-2004.

[89] http://en.gkm.gov.hu/: Ministry of Economy of Hungary: SME Support Programmes.

[90] Internal materials of BALA Company.

[91] Internal materials of SLOVPACK Company.

[92] Internal materials of ENIGMA Company.

[93] Internal material of EURONET WORLDWIDE Company.